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AUSTIN H. CARR, Editor,
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Editorial Comment

Canada's Monetary System Explained

So much has been said and written during the past year or two about the need of monetary reform that the hearer and the reader, unless they keep in mind the principles upon which a monetary system rests, may become hopelessly confused by the various devices suggested as substitutes. The most serious aspect of all such proposed reforms is the reckless abandon with which the would-be reformers advance proposals which in their simplicity bear evidence of a lack of any serious thought having been given to even the elementary principles which underlie a monetary system.

We are glad to be able to publish this month the address in parliament of Honourable Charles A. Dunning, Minister of Finance, on currency and credit in Canada. As Mr. Dunning points out, parliament has already enacted all the legislation necessary in the field of monetary policy, and through the establishment of the Bank of Canada, which is controlled by the government, has provided for the regulation of the volume of currency and credit in the best interests of the economic life of the Dominion.

We believe that every one of our readers will agree that

the members of our profession are expected to be familiar with the details of our monetary system. But have we become fully informed on the system? We can test ourselves by asking a few questions. Is the present volume of currency and credit in Canada adequate for the needs of the people? Give particulars to substantiate the answer. What function does the Bank of Canada perform in our monetary system, and how does it determine its policy? To what economic and financial factors at work in the Dominion must the bank give study? How is inflation possible under our monetary system? What would be the economic effects of inflation and what classes of the population would be affected for better or for worse by inflation?

Mr. Dunning has dealt with these questions and with many more matters of importance. By becoming sufficiently conversant with our monetary system we shall be able to help the would-be reformer to see what lies below the surface that he is "scratching." But we ourselves must be in earnest about it. We can recall an old teacher once telling us that when making a study of one of Shakespeare's plays the first thing to do was to read it through quickly for the story, then a second time slowly in order to become acquainted with the characters and with what they were saying, and a third time to examine minutely each speech and conversation. It seems to us that by some similar formula we can familiarize ourselves with the facts that Mr. Dunning sets forth and shall then be in a position to render a timely service when the numerous opportunities come of discussing the monetary system of our country.

Profession in Great Britain

The public accountant in Canada is in the position of being able to view at a distance the developments that are taking place in a professional way in Great Britain and in the United States, where the membership of the profession is considerably greater than it is in this country. In current issues of the professional magazines of Great Britain reference is made to some matters that should be of special interest to our readers.

As the older members can testify there have been many changes in the nature and scope of the duties of the professional accountant during the past quarter century. There was a time when his services were devoted almost

entirely to the audit of accounts, that is, to the examination of the records of what had taken place months and even years previously. Today the audit forms only a part of his services; his training, experience and judgment have become recognized, and his advice is sought on a variety of subjects belonging to the technical sphere of accountancy. He is moreover being consulted on broader questions of policy in which a knowledge of the influences outside the particular business or firm, of the course of trade, and of future prospects, is imperative if his advice is to carry weight or be of any value to his client.

The Economic Bulletin

The move of the publishers of *The Accountant* (London), then, to issue a quarterly review in which the economic trends in Great Britain and in other countries of the world are summarized is commendable. This new publication known as *The Economic Bulletin* will be under the editorship of Professor J. H. Jones of London University, who is personally known to some of us in Canada and whose contributions on current economic subjects are doubtless familiar to many of our readers.

As Mr. Jones points out in the first issue of the *Bulletin*, a business firm conducts its operations under three sets of influences. The first consists of those peculiar to its own undertaking and forms the subject of consultation between the firm and its accountants whose judgment and advice have been called for because they have been specially trained to deal with these influences. With this set the *Bulletin* does not deal, but gives attention and consideration to the other two. The second set of influences consists of those that are general within an industry but peculiar to that industry or a group of associated industries. The industry may for instance be either a rapidly growing or a declining one, its methods may be highly competitive, or the demand for its product highly sensitive to small changes in price. Consequently, as every undertaking here is one of a family of undertakings, the same policy would not apply when the industry was declining as when it was expanding. Hence the importance of being always aware of economic trends. The third set of influences consists of the wider or more general ones that lie outside the in-

dustry of which the undertaking forms part and include those of an industrial, commercial and financial nature.

Today the members of our profession are consulted on broader questions of policy than at any previous time. They must be at least as well informed as the clients are about general trends in industry, commerce and finance. Thus in introducing the first issue of the *Bulletin*, Mr. Jones states, "The judgment of an accountant upon many issues submitted by clients is influenced by his estimate of the economic situation. Information about the situation may be obtained from numerous documents published here and abroad. But the average accountant or business man cannot spare the time to digest even a small selection of such documents. The purpose of the publishers of this *Bulletin* is to present, in its pages, as careful an interpretation as possible of the statistics indicating the course of industry and trade in selected countries." Our editorial committee welcomes the new publication, and our good wishes are extended to the sponsors and the editor.

Accounting Research

Another development in Great Britain of considerable interest to the profession is that of the accounting research association. The association was organized a year ago and reference to it was made in the February 1937 issue of THE CANADIAN CHARTERED ACCOUNTANT.

According to the first annual report of the association, there is a total membership of 217 consisting of accountants in practice, teachers of accounting and allied subjects, and economists. The initial year's work necessarily had to be of a preliminary nature, but considerable progress has been made. A group has been giving some time to the study of the actual valuation of goodwill in the flotation of public companies in recent years and it is expected that a report will be issued during the present year. The committee of the association has issued two questionnaires, one on the valuation of stock, work-in-progress and raw materials for balance sheet purposes, and the other on methods of calculating depreciation of assets. The co-operation of the officials of some very large undertakings in Great Britain is being obtained, and the results of the committee's work in these directions will be welcomed by the profession in Canada since these subjects, particularly that of inventory

valuations, are ones in which all auditors and public accountants are greatly interested.

Statement of Accounting Principles

What is a principle? According to *The Concise Oxford Dictionary* a principle is a "fundamental truth as basis of reasoning &c." The term "accounting principles" has come to be a common one in the language of the public accountant but for him to explain its meaning or to give illustrations of accounting principles is not easy.

In recent years the New York Stock Exchange has been requiring the auditors of the accounts of corporations whose securities are listed on the Exchange to state, among other things, whether or not the financial statements of the company in question present "in accordance with accepted principles of accounting consistently maintained by the company during the year under review" the position of the company at that date. Quite recently a similar expression has been appearing in the auditors' reports on the balance sheets of some corporations in Canada. What is the significance of the term "accepted principles of accounting" in these reports?

In the hope that there might be established a body of principles which would become useful in unifying thought and which by its acceptance would serve to standardize accounting practice, the Haskins & Sells Foundation of New York in 1935 arranged for a committee of three educationists to make an independent and impartial study of the subject of accounting principles and to prepare a report. As mentioned in our April issue, a copy of "A Statement of Accounting Principles," prepared by Messrs. Sanders, Hatfield and Moore and published by the American Institute of Accountants, was recently sent to the reference library of each provincial Institute. We are pleased to be able to bring to our readers elsewhere in this month's issue a review of this publication by Harold P. Herington, a member of the editorial committee.

Standards in Report Writing

As the reference books on the writing of accountants' reports are few, the editorial committee have had in mind for some time the desirability of publishing an authoritative article on the subject. Their efforts to this

end have been rewarded, and we have for readers this month Mr. Gracey's interesting and helpful article which bears evidence of much thought and care in its preparation by one of wide experience.

The writing of accountants' reports is a matter of so great moment to auditors that the wonder is that there are not more reference books on the subject. The logical answer, we think, is given by A. E. Cutforth, a distinguished member of the profession in Great Britain, in a lecture on the subject in which he stated that report writing did not readily lend itself to being written about in a useful or practical way. "One cannot," he said, "dogmatize about reports in general or reduce report writing to an exact science."*

As pointed out in Mr. Gracey's article, in many cases the only contact which the client has with the principals of an accounting firm is through the firm's reports and letters. How important it is, then, that the annual report on a company's accounts be not only mechanically correct and attractively set up, but that it also bear evidence of care and judgment in its preparation, in the choice of language and in the proper emphasis to be given to pertinent facts.

When the members of our profession are called upon daily to put into writing their observations on a company's annual transactions, how many of them, we have often wondered, recall those significant words of Francis Bacon written over three hundred years ago, "Reading maketh a full man, conference a ready man; and writing an exact man"?

Guide to Statesmanship

At a recent meeting of the Foreign Bible Society in Canada and Newfoundland, His Excellency Lord Tweedsmuir, Governor General of Canada, paid tribute to those engaged in the work of that organization. Among those interested in its activities and success are leaders in every walk of life in the Dominion, and Lord Tweedsmuir made the observation that the greatest of all duties was bringing the peoples of the world into more intimate contact with the literature and teachings of the Bible. "It contains all the traditions and all that constitutes our hope for the fu-

*The lecture was published by Gee & Co., 6 Kirby Street, London, 1934.

ture," he said, "and if it were used more often today as a guide to statesmanship, as it was in the past, there would be more wisdom in the world."

The actions and deeds of any group of people in the great family of nations are after all the reflection, on a large scale, of the feelings and passions that have been allowed to become predominant in their lives. It is because the world and many of the present leaders have got away from the influence of which Lord Tweedsmuir speaks that cut-throat practices prevail in national and international affairs, in business and in social life. The members of our profession are practical men and we believe that though hesitant perhaps in expressing their views they wholly support this sentiment of our Governor General. And may we add what a greatly changed world this would become if every individual were to allow himself to be guided, for instance, by the thirteenth chapter of Saint Paul's first letter to the people of Corinth written nineteen hundred years ago, in which he begged them to be moved by the spirit of charity. Or as the editor of one of Canada's greatest newspapers has put it when speaking of present world conditions, "even a partial adoption of the Golden Rule would ensure peace among men."

DEPLETION IN METAL MINES FOR INCOME TAX*

By Stanley B. Laing, Chartered Accountant, Winnipeg, Manitoba

FOR the privilege of burying hidden treasure of almost inconceivable worth, our Southerly neighbour has been offering a handsome premium above the long recognized standard dollar value of gold to all those who will part with the precious metal. Under the impetus of its purchase of apparently limitless stocks, the industry in Canada has been enjoying a boom of production and development which has been one of the bright spots of our country's struggle for recovery during the current decade.

In discussing the present subject, there is no necessity to elaborate on the advantages to the mining industry of the current situation. It is sufficient to point out what is well known to all who are interested in the various stages of the development of our country, namely, that many low-grade ore properties have been enabled to come into production, which has been a factor in extending the areas concerned with the mining of metals as an industry, and that the increased interest in this development has brought about many valuable economies of production which are here to stay.

To such a point of achievement has the mining industry progressed that it has become the focus of attention for the eyes of debt-burdened fiscal administrators of the various public treasuries. With the extension of territories in which producers are operating, additional tax legislation has followed on the heels of the high earnings, so that the taxation of mining companies' profits and dividends is becoming a matter of increasing interest to the practising accountant.

It has occurred to the writer therefore, that some factual data gathered in connection with a study of the question of depletion allowances might be of general interest.

In his budget speech of 1935, the Minister of Finance stated:

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*This paper was one of two receiving Honourable Mention in The 1937 Essay Competition conducted by *The Canadian Chartered Accountant.*

"With regard to the existing regulations allowing depletion to mines, it is believed that several of these provisions have been unduly generous in their operation. Not only has it been pointed out that the specific rate of 50% in the case of precious metal mines could fairly be reduced, but also that the granting of depletion to both corporation and shareholder at the present rates cannot well be defended."

It will be brought to mind readily that, prior to the changes in regulation forecast in the above statement, depletion for purposes of the Income War Tax Act of the Dominion, as compared with the present, were, namely:

	Prior to 1929		1929 - 1933		Present	
	Company	Share-holder	Company	Share-holder	Company	Share-holder
Gold and silver mines	50%	50%	50%	50%	33 1/3%	20%
Base metal mines ...	25%	25%	33 1/3%	33 1/3%	33 1/3%	20%

In the case of the shareholder, the percentage represents the proportion of the dividends received by him which may be deducted as exempt; in the case of a company, a deduction of the above percentage may be made from net operating income before arriving at the amount which is taxable.

Exemption Allowed Shareholder

The investor in mining stocks is clearly entitled to receive back his capital, which has been put into a wasting asset, by means of the annual or other dividends paid to him, and the taxation of all of such payments in his hands would produce a manifest inequity, unless depletion reserves were recorded from which tax-free disbursements could be made. But if we examine the operation of the exemption allowance made to the shareholder, it will be apparent how difficult it would be to legislate for a scientific and practical allowance which would be fair and equal for all.

Most investors have made their purchases of stock in the open market long after the company has been organized and very often at prices which represented considerable inflation. It may be questioned if a similar allowance for return of capital should be made to a shareholder holding stock at such a cost as to the member of the promotion syndicate who, through splits of stock and discounts, possibly receives as much or more than his initial investment

in each year. Should the latter have his exemption terminated the sooner, and if so, how could administration be set up to handle such a problem?

Without more than this suggestion regarding the difficulty of appraising the reasonableness, or otherwise, of the Dominion system of exemption to the shareholder for depletion allowance, we may examine the treatment in other jurisdictions:

British Columbia:	Dividends exempt entirely if company has paid income tax
Alberta:	No depletion allowed shareholder
Saskatchewan:	No depletion allowed shareholder
Manitoba:	Same exemption as Dominion
Ontario:	Same exemption as Dominion
United States:	Shareholder allowed no deduction, unless distribution is from depletion reserves.

The variance in treatment by the different authorities opens a question as to the principle lying behind the Federal depletion deduction. A scrutiny of Hansard revealed to the writer no lead as to the intention of the legislators, and it must be assumed that the various governments have readily reached accord in a policy of encouragement to an important and growing factor in Canadian annual income.

Depletion Allowance to Companies

The deduction allowable to companies under the Minister's discretion by the Income Tax Commissioner, has apparently been determined by the same considerations, added to which is the outstanding advantage of simplicity in calculation.

The allowance is determined by applying the above mentioned percentage to net operating income which may be described as:

> Gross income, *less* All expenditure (including depreciation on buildings and plant, not above 15%, and development written off, usually at $1.00 per ton) except capital outlays.

The latter may be taken to include costs in erection of buildings and plant, purchase of properties or options, organization expense, development of properties not owned by the company, and similar items.

The accountant, instinctively looking for the scientific method, will wonder on what principle the percentage calculation is based. His reference books, if he finds it necessary to consult them, will suggest that depletion should be calculated in the proportion that the units taken from the mine during the period bear to the estimated content in units of the body of ore, which percentage is applied to the book value of the property costs. It is even suggested authoritatively, that cost of plant and buildings and other such capital assets other than mining properties may be amortized through the annual depletion provision.

In the practical case, two immediate difficulties present themselves. The basis of establishing book values varies in each company to an extent which occurs probably in few, if any, other industries. The introduction of the prospecting, development, exploration, and finally, operating stages, each in the hands of separate parties in many cases, brings about a series of barters, involving the exchange of large blocks of shares at every step. As these shares are usually without par value, or are issued at a generous discount, or represent market values differing greatly from par, the final valuation of the property brings about a nice problem. While the book values as shown are probably satisfactory for most purposes, inequities undoubtedly would occur if they were used as the basis for depletion allowances for taxation purposes.

As an example, one recently established producing company having acquired its properties through the issue of no-par value shares, for which no moneys were paid into the treasury, has set up its mining properties at a value of $1.00. In other cases the valuation is offset by shares issued at $1.00 par value, the number of which is often in excess of one million, thus creating a book value of property of over one million dollars, although, as in the first case, it may be that no cash has been paid in.

The other difficulty arises from the estimation of ore content which forms the basis of the calculation. Some corporations which are exceptionally well organized have been able to produce reports regarding the ore content of their properties which experience has shown to have been reasonably accurate. In many cases, however, and from the point of view of government administration particularly, the appraisal of value in the mine cannot be said to

be prepared on an accurately scientific analysis. Especially is this the case in mines which have only developed a portion of their claims and those which are in the earlier stages of mining their ore bodies.

If consideration is given to these problems, it is apparent that the practice of the Federal authorities may be "well defended" on the one important ground of its simplicity of calculation. In applying the method which has been used, however, one feature arises which to the writer seems to be indefensible.

Year after year the companies are allowed to accumulate the exemption for depletion, as referred to above, without regard to the relationship between the amount allowed and the cost of the mining properties as shown by the records of the company or measured in any alternative way. Clearly, the policy has been dictated by considerations economic and industrial, to which reference has been made earlier. Yet the practice catches the eye as a strange one, by an administration which is compelled, at times, to adopt a highly technical procedure.

It is of considerable interest to examine the methods which have been enforced by other authorities to meet the difficulties which are inherent in the problem of attempting to reach a reasonable, fair and equal allowance.

It was intimated by the speakers for the government in the early stages of the Income War Tax Bill that the basis of income taxation which had been in force for some years in the United States served, to some extent, as a model for their proposals. The practice regarding depletion in the legislation of that country is, therefore, of prime interest.

Procedure Under United States Law

In the Act of 1918 depletion is allowed annually on the cost, or value at "the basic date," which is defined as March 1, 1913 (the time of introducing the taxation liability), or the date of acquisition or discovery after that date. The company is required to estimate the mineral contents of the mine according to definite regulations and geological standards from which the "unit of estimate" will be determined. Cost must represent a *bona fide* purchase, and fair market value at any basic date must be arrived at according to lengthy and specific rules, subject

to approval by the Commissioner. The annual charge for depletion may be calculated in the ratio of units sold to total available units of the "value remaining for depletion." The latter value is defined as cost or value at basic date, plus additions allowable, and minus depletion and depreciation sustained, together with the value of land for other purposes than mining, the amount recoverable through depletion being the total capital less the sum recoverable through depreciation.

Depletion under the statute is only admissible to the point where the total equals the cost (or value at basic date), plus subsequent allowable additions, except in the event of further discovery.

In his "Income Tax Procedure," R. H. Montgomery has referred to the difficulties which arose in the practical application of even such well stated multifarious regulations. In attempting to check the estimates and values, the Bureau soon became years behind in its work. There was much dispute regarding the principal units to be used, having regard to the production of various metals in the same operation, and low and high grade ores often occurring in the same mine. A gradual evolution of method, in part at least, came about as a result.

The Act of 1921 recognized that some products may be used in the process of industrial production (e.g., coal) and the annual charge was allowed on the basis of "units sold or produced." In other provisions regarding the subject there was no important change. By the Act of 1924 a limitation of 50% of net income was placed on the allowance for depletion which was based upon a "discovery value," where net income is computed before depletion deduction. The same principles were continued in the Act of 1926 which returned to the "units sold" basis.

An entirely new principle was introduced by the Act of 1932 by which the taxpayer was given a prior election to be allowed a percentage based on gross income. In the case of metal mines the percentage was 15 per centum with a maximum of 50% of net income. Costs of crushing and concentrating were the only allowable process deductions in arriving at gross income. This basis might, upon election, be substituted for the unit calculation referred to above, which was enforced when there was no election taken. It is noted that under the percentage depletion basis,

the aggregate allowable deductions may exceed the cost or other bases ultimately, or may never be as great. In 1934 and 1936 the new Acts continued the same practice.

The complication and multiplicity of the many articles of regulation on the subject of depletion alone leads one to rejoice in the simple annual application of a definite percentage to net operating income as disclosed. The methods adopted to reach a scientific calculation under the United States Acts must, at least, have proven a great boon to the practice of accountancy.

Treatment in Other Countries

Under the British tax system there is no allowance for depletion.

In South Africa each year's allowance is calculated by dividing the net balance of capital expenditure by the life of the mine which is determined by the government mining engineer (subject to appeal) with a maximum of thirty years. In determining the balance of net capital expenditure for the following year, the allowance is deducted. Thus a definite limit to the aggregate amount claimed is set.

Provincial Allowances

The Province of British Columbia, which has been in the field of income taxation for many years, has developed a system which is stringent in its application as compared with the Dominion practice. Depletion is calculated on the unit basis up to the amount of total cost of the mine. In the valuation of cost, only the *money* cost may be used, which in most cases would be very much less than the book values where the offset represents shares issued.

In the prairie provinces, sufficient experience of producing companies has not been gained to necessitate final establishment of rulings on the subject. Some reference to the subject appears in the paper on "Mining Taxation" by E. D. Fox as contained in THE CANADIAN CHARTERED ACCOUNTANT of June, 1934. In general terms, Alberta might be expected to favour the Dominion procedure; Saskatchewan suggests a practice similar to that of British Columbia, while Manitoba, although following the Dominion system, anticipates a limitation to the claims for depletion when the property costs have been returned through the aggregate exemptions.

The Corporation Tax Act of Ontario, under its revenue features, makes an allowance equal to the Dominion calculation. Presumably this amount may be deducted continuously without regard to the relationship of such accumulation to the capital investment in property. In Quebec, mining companies are exempt from the Corporation Tax Act and taxed under the Mining Act under which no allowance is made. Under the similar Ontario statute, a deduction from gross income of fifty cents per ton of ore is allowed.

One further note remains to be made. The student has probably gazed with wonder at the balance sheets of mining (metal) concerns and searched for the reserves for depletion in vain. In no case which has appeared before the writer has any book entry been made. In the United States, reserve provisions are required to be recorded; this may result, of course, from the capital gain and loss feature of their taxation principles. A clue to the reason for our practice may be that suggested by G. C. Andrew, "although done occasionally is not recommended in view of the capital tax act."*

It may be suggested reasonably that the allowances for recovery of capital should have a definite point of termination—when the capital has been recovered. And without considering that the investor in mining shares, because of the unusual risks to which his capital may be subjected, is entitled to extraordinary returns, which should be tax free, there would seem to be no inequity in terminating the allowance when the aggregate claimed has reached a sum equal to the *money* which has been paid out by the company or its predecessors for the acquisition of the claims or lands.

It may be held that this is a special concession to the industry which is desirable because of the heavy risks involved. If this be acceptable, it may well be suggested that some better method could be adopted in preference to a reduction in a tax which is only applicable when there are profits shown.

The matter of expenses paid out for exploration and development prior to the period of production has received more reasonable treatment by the tax department. A de-

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duction by way of amortization has always been allowed, very often at \$1.00 per ton of ore milled, but at a rate determined by mutual arrangement. It will be noted that under section 89 of the Income War Tax Act, regulations have been issued by which the claim is limited to \$3.00 per ton.

It appears to the writer that an annual deduction should be made to cover both depletion and pre-development expenditures; that the allowance should be related rather to production than to net income; and that no further amount should be deductible after the money put into property has been recovered and development costs amortized.

In arriving at the rate in each case, the same procedure would necessarily be followed, as is now in use in determining the rate to apply for development write-off. In some districts more dollars per ton would be allowed than in others, due to low-grade ore, or to peculiarly difficult geological formations with which the company is required to work; but each case would have to be analyzed on its own merits. The services of expert mining engineers from other departments could well be utilized, as is the case in South Africa.

It is believed the following advantages would result:—

1. Each company would receive an annual estimate based, within certain limitations, upon its own situation.

2. The allowance would be a positive one, not contingent upon the earning of a net profit.

3. The taxpayer, while receiving a reasonable annual deduction toward the loss of capital, would not be entitled to claim more than has been put into the enterprise.

It is true that this basis would be open to one of the objections which were pressed regarding the unit system, that is, that it relies upon estimated quantities of ore. It may be advanced in its favour though that it is a simpler rule; that it improves upon the estimated life basis in giving weight to variations in annual production; that more general data could be utilized than is possible in the calculation of the unit system for each mine, in that a rate per ton could be developed in each district from a statistical review of costs to bring the various properties into production; and that it gets away from the book values of property costs as a basis.

Any calculation would provide a ready basis for determining the proportion of dividend payments to shareholders which should be exempted, if a condition of entry on the company's records be attached. In the absence of any reserves it is difficult to support the present practice in view of the speculative rather than investment interest of so many mining stockholders and the unusually large returns which are received when a property does reach the stage of bullion shipment. In order that those whose chief livelihood arises from funds invested in the development of mines might not suffer a capital appropriation, some allowance may be reasonable but it should be based on actual recorded estimates from which payments may be deducted. It is noteworthy that many of the authorities make no dividend exemption.

In conclusion, we may quote one taxation authority of considerable experience in his summary of the question—"Depletion, like depreciation . . . . . only more so . . . . . is one of the most intricate, and troublesome problems in the whole sphere of taxation."

MINING TAXATION IN MANITOBA*

By J. P. De Wet, Winnipeg

ON MARCH 15, 1938, the Manitoba legislature assented to the following scale of taxation on mining companies operating metalliferous mines in the province: Where the income is not in excess of $100,000 the tax is 5 per cent. (on all the income); where the income is in excess of $100,000 but not in excess of $400,000, 6 per cent. (on all the income); where the income in in excess of $400,000 but not in excess of $700,000, 7 per cent. (on all the income); where the income is in excess of $700,000 but not in excess of $1,000,000, 8 per cent.; where the income is in excess of $1,000,000 but not in excess of $1,300,000, 9 per cent.; where the income is in excess of $1,300,000, 10 per cent. (on all the income).

It should be noted by way of comparison that the rate of taxation on corporations and joint stock companies other than mining companies is 10 per cent. on all the net income when this exceeds $19,000. The concession to mining companies is a recognition of special circumstances that affect such companies, notably the speculative risks that attend mining enterprise in general, quoted by some authorities as high as 100 to 1, and by others as 400 to 1. The large investments required to establish a mining company in production also must be considered.

In the calculation of a mining company's income for the purpose of taxation, this "formula" is used:

Revenue from bullion sales, net of mint charges, freight, etc., *less* mining costs - - including write-off of development costs prior to production, usually at $1.00 per ton of ore milled. Milling costs - - including depreciation of plant and machinery, not in excess of 15 per cent. per annum. Administrative expenses. Financial charges. Resulting in net operating profit, *less* one-third thereof as a depletion allowance - - resulting in taxable operating profit. *Add* income from investments, - - resulting in Dominion taxable income (or Manitoba portion thereof). *Less* Dominion Income Tax of 15 per cent. paid (or portion) - - leaving Manitoba taxable income.

It should be observed here that Manitoba taxes what is left after the Dominion Income Tax is paid. Thus on

*We are indebted to "Canadian Finance" of Winnipeg for this article on mining taxation—a subject of considerable interest to accountants.—*Editor.*

the basis of the Dominion taxable income, Manitoba's 5 per cent. on companies whose net income is not in excess of $100,000, is effective only 4.25 per cent.; 6 per cent. is effective only 5.1 per cent.; 7 per cent is effective only 5.95 per cent.; 8 per cent. is effective only 6.8 per cent.; 9 per cent. is effective only 7.65 per cent.; and 10 per cent. is effective only 8.5 per cent. Profits are taxable as soon as earned in all provinces, but the Dominion government permits an exemption of three years for companies coming into production between May, 1936, and January, 1940.

Another point to be observed is that Ontario is the only other province in the Dominion that taxes what is left after the Dominion Income Tax is paid. British Columbia, Quebec and Saskatchewan tax the full amount. A further point is that Ontario's tax on companies whose income is not in excess of $1,000,000 is 3 per cent. after a statutory allowance of $10,000, 5 per cent. above $1,000,000 and up to $5,000,000, and 6 per cent. above $5,000,000. Capital, corporation and place of business taxes also are imposed, *vide* accompanying table.

Quebec also grants a statutory allowance of $10,000, after which the tax is 4 per cent. up to $1,000,000, 5 per cent. above $1,000,000 and up to $2,000,000, 6 per cent. above $2,000,000 and up to $3,000,000, and 7 per cent. above $3,000,000. British Columbia's tax is 10 per cent., or a royalty tax, whichever is the higher.

A fourth point is Manitoba's liberality in respect to pre-production development cost write-off. Manitoba's write-off allowance is the same as the Dominion, usually $1.00 per ton milled, but may be as high as $3.00 per ton milled, whereas Ontario makes an allowance of 50 cents per ton milled.

The accompanying table presents comparisons of the estimated taxation a company located in Western Ontario paid to that province's government and to the Dominion government in 1936, as nearly as can be arrived at from available figures, and also what it would have paid had it been situated in Manitoba. (See Table on page 340).

In studying the table note that the depletion allowance of one-third off net profit reduces the Dominion 15 per cent. tax to an effective 10 per cent.; and reduces the Manitoba tax of 4.25 per cent. (*vide* paragraph 5), to an effective 2.83 per cent.; 5.1 per cent. to 3.4 per cent.; 5.95 per cent. to 3.87 per cent.; 6.8 per cent. to 4.5 per cent.; 7.65 per cent. to 5.1 per cent.; and 8.5 per cent. to 5.7 per cent.

The following comparison of taxes paid to the Dominion, Manitoba and Ontario governments is made by taking figures from a statement of a mining company in western Ontario which reported gross production for 1936 at $1,144,154. The Ontario tax figures are not guaranteed to be scrupulously exact, but the calculation below shows the company to have paid to the Dominion and the Ontario governments $64,599, whereas the company's balance sheet shows "Reserve for Dominion and Provincial Taxes, $65,101.88."

	Dominion		Manitoba		Ontario	
Production		$1,144,154		$1,144,154		$1,144,154
Operating and Marketing Charges	$539,219		$539,219		$539,219	
Depreciation	71,447		71,447		71,447	
Milling Allowance, 50c a Ton	.....		.....		29,233	
Deferred Charges at $1.00 Per Ton	58,466		58,466		.....	
		669,132		669,132		639,899
Net Profit		$ 475,022		$ 475,022		$ 504,255
Less Depletion Allowance, 33 1/3 Per Cent.		158,340		158,340		.....
Dominion Taxable Income		$ 316,682		$ 316,682		
Dominion Tax at 15 Per Cent.		$ 47,502				
Less Dominion Tax				47,502	$ 47,502	
Taxable Income				$ 269,160		
Tax at 6 Per Cent.				$ 16,151		
Less Statutory Allowance					10,000	
						57,502
Taxable Income						$ 446,753
Tax at 3 Per Cent.						$ *13,402

*This figure probably is lower than the amount actually paid.

This company also paid Provincial Capital, Corporation and Place of Business taxes amounting to $3,695, or a total of $17,097 to the Province of Ontario, as compared with $16,151 in Manitoba.

Thus the Manitoba tax rate on Net Profit of $475,022 is 3.4 per cent., and the Ontario tax rate on $504,255 Net Profit is 3.39 per cent.

CURRENCY AND CREDIT IN CANADA*

By Honourable Charles A. Dunning,
Ottawa, Canada

DURING this session there have been frequent references to monetary reform, not only by those who profess so-called social credit principles, but also by many other members. The right honourable leader of the opposition, while not very specific, stated on one occasion that we should not be incapable of making progress in monetary reform. He made general references to what had been done in Australia, New Zealand and South Africa, but he was very careful to point out that while these dominions had acted with great courage, conditions differed in different parts of the empire. He said that what was true in one dominion could not always be said to be true in another. Other honourable gentlemen have also referred to monetary policies and some have suggested various experiments in monetary reform.

First let me say that in my opinion it is unnecessary and confusing to speak about the need of enacting new laws in the field of monetary policy. Parliament has set up an institution, now controlled by the government, charged with the specific duty of regulating the volume of currency and credit in the best interests of the economic life of the nation. Those words I quote from the statute itself. That is now the function of the Bank of Canada. The bank is already in operation, and I am convinced that its directors and officers are attempting to perform their high task to the best of their ability and with a singleness of purpose that excludes all considerations except the promotion of the permanent welfare of the general mass of people in this country. Many honourable gentlemen realize what they have been doing. Some may not agree that what they have been doing is best for our country; but in order to keep the issue clear, let us agree that when honourable members advocate some experiments in monetary policy, some vague monetary reform, what they are really doing is criticizing the policy of the Bank of Canada. Of course that is the right of any honourable

*Part of an address delivered by Mr. Dunning, the Minister of Finance, in the House of Commons on 8th March 1938.

member, but we will avoid confusion if we define the issue clearly.

The Bank of Canada

I propose, therefore, to say something about the policy which the Bank of Canada has been following as shown, not by confidential information available to me in my official capacity but by the bank's published statements. To make more clear the results already accomplished, I shall find it necessary to review briefly the Canadian monetary policy during the whole depression. Before doing so, however, it might be well to define our terms and to refer briefly to the methods by which the Bank of Canada can perform its primary purposes of controlling the volume of currency and credit in use.

By the term "currency" most of us refer to money in its narrower sense, that is to say, our bronze, nickel and silver coins, and our paper money. Our metallic coins are merely the small change of ordinary business transactions, the hand to hand money convenient for the purpose of making change. The volume of these coins in circulation is practically self-regulated. We issue them from the mint through the Bank of Canada in accordance with the public demand. If business activity and particularly retail trade are expanding; if prices are rising, the public will require more of them and the Bank of Canada will receive requests from the chartered banks to ship more five or ten cent pieces to the maritimes, more fifty cent pieces or more silver dollars to British Columbia, and so on. If we shipped more than the needs of business demanded, they would merely pile up on the bankers' shelves and become redundant. They constitute no real problem of monetary policy.

Paper money in Canada now consists of two types: first, chartered bank notes and, second, Bank of Canada notes. Chartered bank notes are subject to rigid limitation under the existing law as to maximum issue. That maximum will decrease year by year until 1945 when the banks will have the right to issue only up to twenty-five per cent. of the amount of their paid-up capital. Bank of Canada notes may be issued by the bank subject only to the limitation that the bank must keep a reserve of at least twenty-five per cent. in gold against its total note and deposit liabilities. The small denominations of Bank of Canada notes, chiefly

the ones, twos and fives, constitute the large change of hand to hand circulation.

In addition, Bank of Canada notes have another important function. Being legal tender they may constitute legal reserves for the chartered banks. In other words, our chartered banks keep Bank of Canada notes as well as deposits in or balances with the Bank of Canada as the cash reserves which they are required to maintain against their demand liabilities, comprising both notes and deposits within Canada.

Managed Paper Standard

I shall not introduce the qualifications I would be required to introduce if I were dealing with the regulation of currency and credit under gold standard conditions. Contrary to what I sometimes read in newspaper editorials, we are not on the gold standard and are not subject to its deflationary or other controlling influences. We have long since cut adrift from gold. For better or for worse; for the time being at least, we are on a managed paper standard, just as is the United Kingdom. It is true that the Bank of Canada is required to keep a minimum gold reserve of twenty-five per cent. of its combined note and deposit liabilities, but the value of our currency is determined not by gold but by the principles which govern managed paper standards and which may be summarized as demand and supply. So much for currency.

Circulating Credit

What do we mean by "credit" in this limited sense? For our present purpose "credit" means circulating credit or bank deposits. As everyone knows, the story of the last century or more, particularly in the Anglo-Saxon countries, is a story of the gradual rise of bank deposits to perform the monetary work of the business world. As a circulating medium bank deposits have been found to be infinitely more convenient than currency, and today in Canada, in the United States and in the United Kingdom, they are the vehicle by which ninety or ninety-five per cent. of business transactions are effected. As they are in quantity the most important by far of all our circulating media and moreover, since they are subject to wide swings of expansion and contraction, it is the control of their volume to which we mainly refer when we speak of the central

bank's function of controlling the volume of currency and credit in use.

Power of Regulation and Control

I come now, Mr. Speaker, to the methods by which the central bank exercises this power of regulation and control. These movements will warrant careful study by all honourable members, but here I can do little more than refer to them.

1. Open Market Operations

Briefly stated, the Bank of Canada exercises its control over the chartered banks by operating on the cash reserves of the banking system, either by conducting so-called open market operations or by altering its rediscount rate, or by both. Our chartered banks, like all commercial banks, are accustomed to keep a certain proportion of cash as reserves against their note and deposit liabilities. In practice they have found it necessary to keep this cash reserve in order to be able to meet the demands for cash that may be made upon them at any time by their note holders or by their depositors. In Canada the cash reserves of our chartered banks consist of notes of the Bank of Canada and deposits by the chartered banks with the Bank of Canada. Speaking of the banks as a whole, the proportion or percentage of cash which the banks keep is in practice about ten per cent., and by law it must be at least five per cent. The Bank of Canada can expand or contract these collective chartered bank reserves at will, always providing that it can buy and sell securities or other suitable assets when it wants to. It is the buying and selling of securities for this purpose by the Bank of Canada that are commonly known as open market operations.

Suppose, for example, that the Bank of Canada buys ten million dollars' worth of securities. Then, no matter from whom it buys those securities, the reserves of the chartered banks as a whole will rise by the amount of ten million dollars. If it buys from other banks, their accounts at the central bank will be credited, and those accounts are part of the chartered banks' cash reserves. If it buys from an individual, then that individual pays the money into his account with his bank, and when that bank presents the cheque to the central bank to be paid by it, then that chartered bank's reserves at the central bank are raised by the

same amount. Obviously, if each chartered bank has some percentage of cash reserves which it thinks it is necessary to maintain, the banks which eventually are credited with the additional cash and which thus find their cash reserve percentage increased, will wish to reduce it again. Otherwise they are losing the opportunity of increasing their earnings. Consequently such banks will take steps to increase their own assets and deposit liabilities by amounts sufficient to reduce their cash reserve percentages to near the customary level again.

As we have seen, the Canadian chartered banks as a group think it expedient to maintain an average reserve of ten per cent., and consequently if, as a result of the purchase of ten million dollars' worth of securities by the central bank, the reserve of the chartered banks has been increased by ten million dollars, the chartered banks will seek to expand their assets and deposits by approximately one hundred million dollars.. Thus it is that the security purchases by the Bank of Canada tend to expand bank deposits in the country by approximately ten times the amount of the transaction.

You may ask just how the chartered banks will expand their assets and deposits as a result of open market operations by the Bank of Canada. If the chartered banks can find good borrowers they will tend to increase their ordinary commercial loans, and by so doing increase their deposit liabilities by a similar amount. Otherwise they may buy investment securities which will usually earn them a considerably lower rate, or they may expand partly in one way and partly in the other. Either move will increase the aggregate of deposits of the banking system as a whole.

It is of interest to note that the chartered banks will all expand more or less in proportion to their relative size. Otherwise some will lose cash reserves to others and will find their individual cash reserve percentages dropping too low.

I have referred to the effect of the Bank of Canada purchasing securities. Precisely the opposite effect will ensue if the central bank sells securities. There will be a corresponding fall in the cash reserves of the chartered banks, a reduction of the average cash reserve of the banks as a group, and a consequent necessity for collective contraction of deposits on the part of the banking system.

2. Altering Rediscount Rate

The second well known mechanism by which the central bank exercises control is the deliberate raising or lowering of its rediscount rate. High rates, of course, tend to contract business enterprise, and low rates tend towards expansion. The control exercised by this method is indirect rather than direct, and it may not be very effective unless there is a well developed money market sensitive to changes in discount rates. These are the major weapons which the central bank may use in carrying out its primary function of controlling the volume of credit and currency in use in the country.

Monetary Policy During the Depression

In order to obtain a proper perspective from which to consider how far the bank has carried out its duties, let us glance back over the course of monetary policy during the depression. It will only be necessary to call attention to a few salient points. We recall too keenly the vicious spiral of deflation which pursued its devastating course from the end of 1929 until the beginning of 1933. On December 31, 1929, Canadian deposits of the chartered banks totalled $2,270,000,000. This volume of deposits was based on a cash base of about $228,000,000, which had been expanded rapidly as a result of advances made under the old Finance Act. These advances had increased to $81,700,000 on December 31, 1929. By October 31, 1932, the cash in Canada had been reduced to $183,000,000, of which only $27,500,000 was based on Finance Act advances, and Canadian deposits had shrunk to $1,960,000,000. This represented a contraction of over fourteen per cent. in circulating credit.

I shall not take time to debate the difficult theoretical problem as to whether this credit contraction was the cause or the result of the liquidation of business and the fall in prices. I shall merely state what I believe to be the prevailing view among competent economists, that while in the early stages of the depression the contraction of credit was probably largely the reflection of the decline in business and prices caused by fundamental economic maladjustments, yet after a time the monetary and credit factor became definitely an important cause.

From early in 1931 to the United States banking crisis in March, 1933, credit liquidation was certainly a factor

operating with cumulative force to aggravate the decline in business and prices. Here was a time when, if ever, the use of monetary policy was justified as a weapon against the ravages of deflation. However, no action was taken until about the close of this deflationary period, in November, 1932, when my right honourable friend persuaded the chartered banks to issue $35,000,000 under the Finance Act in order to relieve the cash shortage which had developed and which threatened to become more acute. I am not inclined to criticize my right honourable friend for the action he then took, certainly not for his general objectives. I realize, of course, that the machinery which was available to his hand was inadequate and cumbersome, and that any bold and aggressive measures would have been bound to meet the strongest possible resistance from the orthodox financial world.

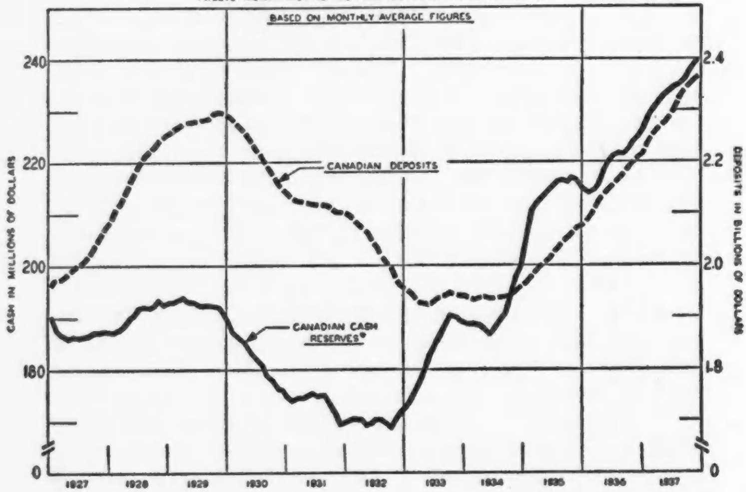
The expansion of bank cash, which began in November, 1932, was soon followed by a cessation of the declining trend in Canadian deposits; and when, following an amendment to the Dominion Notes Act of June, 1934, a further substantial expansion of bank cash occurred, Canadian deposits began a rapid rise which has continued until the present time. In March, 1935, the Bank of Canada commenced to operate as a central bank and assumed responsibility for the regulation of the cash reserves of the chartered banks and consequently of the volume of credit in circulation. Recognizing that the regulation of the country's credit and currency was so vital a sovereign function that it could not be left in the control of a private institution, this government in 1936 amended the Bank of Canada Act to give the Dominion government effective control over the bank by majority ownership of the capital stock and majority control of the board of directors.

Financial Machinery Now Considered Adequate

I think it may now be fairly said that one of the difficulties which my right honourable friend was concerned with in 1931 and 1932 has been removed. Canada's financial machinery is now adequate to enable the government to cause effective action to be taken in the field of monetary policy to the extent that monetary methods may be appropriate to solve our problems.

ALL CHARTERED BANKS CANADIAN CASH RESERVES AND DEPOSITS

TWELVE-MONTH MOVING AVERAGES PLOTTED ON TWELFTH MONTH



*Prior to March, 1935, these reserves are the sum of gold and coin held in Canada, holdings of Dominion notes, and deposits in the Central Gold Reserves not required as backing for excess chartered bank note circulation; in March, 1935, and after they consist of deposits with the Bank of Canada and holdings of Bank of Canada notes.

To enable the house to follow my discussion of past and present conditions, I have had a chart prepared showing clearly the trend of the cash reserves in Canada and Canadian deposits of the Canadian chartered banks. The chart shows the course of these two fundamental factors from the beginning of 1927 until the end of 1937. If honourable members follow these two curves, they will note the rapid expansion of credit in the boom years, the drastic deflation in the early years of the depression to which I have just referred, the effect of the action taken in November, 1932, and in the fall of 1934, and the expanding trend of bank cash and Canadian deposits from 1934 right up to the present time. I think this chart may come as a revelation to some who have been inclined to criticize Canadian monetary policy of recent years as deflationary or insufficiently expanding. Consider the figures. On October 31, 1932, as I have already stated, cash in Canada was $182,-000,000, of which $27,500,000 was due to bank borrowing under the Finance Act. As of the same date Canadian

deposits had fallen to the low level of $1,960,000. On March 31, 1935, the end of the first month in which the Bank of Canada was in operation, the cash reserve of the chartered banks was $200,600,000, and their Canadian deposits were $2,033,600,000. As at December 31, 1936, bank cash had increased to $250,000,000 and Canadian deposits had increased to $2,387,000,000. It should be noted that this expansion in bank cash has taken place despite the fact that the chartered banks have not been borrowers at the central bank. There are only one or two instances of such borrowing, and only for very short periods. It should be noted also that Canadian deposits—and, mark you, these represent the credit which does ninety to ninety-five per cent. of the money work of Canada—are now at a level nearly twenty-two per cent. above the figure for October 31, 1932 and over $117,000,000 higher than at the end of the boom year 1929. Is it any wonder that I find some difficulty in restraining myself when I read certain newspaper editorials and listen to certain speeches?

Let us approach these figures from a different angle. It is usually the case that an argument with regard to monetary policy can never be settled, because it is impossible to determine exactly what would have happened if some other policy had been followed. But in the case of Canada during the last five or six years we can get some idea of what the banking and monetary situation would have been if no action had been taken in the monetary field. I assume first of all that the chartered banks would have regarded the Finance Act as a temporary source of funds for seasonal purposes. They would not have been willing to remain indebted to the government for long periods of time. Such an attitude on their part is a perfectly proper and understandable one. Rediscount facilities are intended to fulfil temporary needs and not to supply permanent or semi-permanent requirements. On this assumption the cash reserves of the banks today would be about the same as they were in October, 1932, after making two deductions. The first deduction represents the amount they were then borrowing under the Finance Act, namely $27,500,000. The second deduction represents the subsequent increase in the active note circulation after making allowance for the notes which could have been supplied by an increase in the chartered banks' own issues. Making those

two deductions, I assume that the amount of bank cash today would have been about $114,000,000 if no action had been taken to remedy the situation. As I do not believe that the banks would have found it wise to operate on a cash ratio of less than, say, 8½ per cent., which is a very low ratio indeed, their Canadian deposits would have been in the neighbourhood of $1,340,000,000 instead of the actual figure of $2,387,000,000, as they were at December 31, 1937. Naturally their assets in the form of loans and investments would have been lower by and approximately equal amount.

I realize fully that the situation which I have just outlined would have been found intolerable long before 1938, and that action to remedy it, first perhaps by temporary measures and later by the creation of a central bank, was inevitable in the best interests of this country. But let me contrast the situation as it threatened to be with the situation as it has actually been. First of all, by appropriate monetary action, the increase in note circulation required for use by the public because of better business, increased employment and higher payrolls, has been taken care of by the central bank with no drain on the cash reserves of the chartered banks and therefore no need for curtailment of credit or liquidation of investments. On the contrary, the cash reserves of the banks have actually been increased by an amount which has enabled them to expand their commercial loans and to add substantially to their investments. The keen desire of the banks to find remunerative employment for their funds has meant that no borrower to whom they thought it was reasonably safe to lend had difficulty in obtaining the accommodation he required. Governments which command the confidence of the investing public have been able to do a tremendous amount of new financing and refunding at very low rates of interest. Corporation refunding and repatriation of debt have been accomplished on a large scale, and an increasingly effective treasury bill market has been developed.

Lastly, we have today a monetary structure which is fully capable of meeting without strain the requirements of an increasing volume of business as and when developments in the non-monetary field create a demand for additional funds; and we have a central banking organization

which provides the machinery for such adjustments as may seem desirable from time to time.

It is perhaps not unnatural that what has been done in the monetary field has not attracted the attention of the average man. But the very fact that our monetary machinery is thought by so many to have done nothing when, in fact, it has done so much, is to my mind a testimony to the quiet effectiveness of the policy followed. There has been no crying from the housetops, no spectacular announcements of policy followed by reversal of that policy. These things may attract newspaper attention, but they disturb the normal course of business and tend to defeat their own ends. On the other hand, let me assure you, sir, that there has been no concealment in these matters. The figures are available for those who care to study them.

Anyone who takes the trouble to do so can find the Bank of Canada's policy mirrored in its own weekly statements, and the effects of that policy in the monthly statements of the chartered banks. Contrast, for instance, the first weekly statement issued by the bank on March 13, 1935, with the statement for December 31, last, and you will find some illuminating changes. During that period of about two and three-quarter years the bank's note circulation has increased by $68,000,000. Its investments increased by $36,000,000, and gold is up $73,000,000 because of the revaluation which took place in July, 1935. Finally, chartered bank deposits with the central bank and their holdings of Bank of Canada notes have risen by $41,000,000. This latter total is the increase in bank cash which has made possible an expansion of over $350,000,000 in Canadian bank deposits or Canadian credit during that period of two and three-quarter years.

I submit that this is a record of which we may well be proud. It is a story of the carrying out of an easy money policy demanded by the public good. It is a story of efficient administration characterized by a full mastery by the management of the bank of complicated monetary technique and by a thorough grasp of sound objectives for the Canadian people as a whole. Some apparently think that it has not been pushed fast and far enough; there are others who fear the reverse may be the case. These latter, in my opinion, are too much bound down by what they

regard as orthodox tradition, and too little conscious of the pressure which had been crushing so many important parts of our economy. The super-expansionists, on the other hand, are too little aware of the complicated forces with which we are dealing, too inclined to oversimplify the problem, too blind to the probable repetition of the evils of such a hectic inflationary boom as has caused much of the misery from which we have been suffering since 1929. In this, as in so many other cases, wisdom is likely to be found in the middle course.

How Bank Determines Its Policy

I am sure the house will desire to know on what basis the Bank of Canada has determined the policy which it has followed. In other words, what are the criteria which must guide the central bank in carrying out its important task? What economic factors does it watch? How does it interpret current trends? By what objective standards does it decide that it should go so far and no further, to quote the act, "in the best interests of the economic life of the nation"?

These are very difficult questions to answer. There is no simple mathematical formula which the bank can use to find an easy answer to its fundamental problem, no single test which it can use. If there were such a simple formula or a single test, we should probably not need a central bank with its highly specialized staff. There is little difficulty in defining the general objectives of the central bank and of the government which controls it. These objectives are the maximum possible sustained level of productivity and the minimum possible level of unemployment. Monetary policy in itself cannot enable us to reach these objectives. A bad monetary policy can impede us; a good monetary policy will assist progress towards the desired ends if other factors are favourable.

If the country is suffering from abnormal unemployment and if the volume of production is relatively low, then there is a prima facie case for an easy money policy. If production and employment in the country as a whole are at a high level, the objective is naturally to maintain the equilibrium. Gradual growth in the population of productivity per capita might in such case call for a moderate enlargement of the credit base, that is, the cash reserve

of the banking system year by year. The third case which we may visualize is one in which boom conditions, sure to be accompanied by unwise use of credit and increased maladjustments, are seen to be developing. In such circumstances the central bank may try a direct attack on the source of trouble if it is limited in its character; but if it is widespread, general restrictive action may be necessary.

Study of Economic Factors

This description of monetary policies, which might be appropriate under varying conditions, is of course of a most general nature. I shall try to supplement it by indicating some of the things which a central bank must study in order to arrive at an appraisal of the existing state of affairs. The most important indications will be found in a study of all data relating to production, distribution, and employment; changes in the general price level of wholesale and retail goods, in the cost of living and in the relationship of these one to another; any available information regarding changes in the relationship between prices of consumers' and producers' goods, manufactured goods and primary commodities, especially foodstuffs; and changes in import and export prices, in other words, the "terms of trade." Lack of equilibrium between these separate sets of prices is liable to upset the balance of payments and the national income.

Even in a closed economy—by what I mean a self-sufficient economy, shut off from the rest of the world—the exchange of goods within the country will be impeded, and the national income therefore diminished, if the purchasing power of any one section of the country is altered at the expense of another section. And in an economy like ours, which is not closed, the relationship of these various groups of prices to similar groups in other countries must also be studied, because a change in prices internally as compared with prices externally may mean, eventually a change in the balance of payments. Similarly, changes in the volume and nature of production must be studied; for if these depart from a reasonably balanced relationship, and goods are produced which there is no opportunity to sell at a profit, price relationships will be disturbed, unemployment will result, and the national income will be diminished. Failure to sell will be reflected in growing inventories. I

do not suggest that monetary policy by itself can restore equilibrium in such cases; but developments of the kind just indicated are danger signals which must be observed by a central bank because of the effect which they may have on general business, and because of the possibility that action by the bank, or by the government in a non-monetary field, may contribute to the restoration of equilibrium.

Another factor which may create disturbances in the national economy is the action of governments, national, provincial and municipal. Hence the budgets and policies of these public bodies must be studied by the central bank.

Study of Financial Factors

Then there are financial factors which in the short run are largely dependent, and in the long run entirely dependent, on the economic factors already referred to. Capital movements, short term and long term, can be so disturbing that the central bank's short term policy may be directed entirely to counteracting them, or on the other hand so beneficial that its short term objective is secured for it without having to take definite action. Of the importance of speculation, either in the stock market or in commodities or in real estate, we have had so many illustrations in recent years that it is unnecessary for me to do more than mention this factor. In connection with its open market operations and its function as financial adviser to the government, a central bank must of course study continuously the bond market, and indeed, the capital market as a whole. This is a day to day matter.

Particularly necessary is it that the central bank should examine the country's balance of payments and its current and prospective development. Changes in imports and exports must be watched, and study of the effects of tariffs at home and abroad also comes into the picture.

Is the country a creditor or a debtor nation? If it is a creditor nation, is it employing its favourable balance in a manner to stimulate the international exchange of goods or services, or is it endeavouring to strengthen its reserves? Do these reserves need strengthening? If it is a debtor nation, how long can it or should it go on borrowing, and on what terms? If foreign debt is being repatriated, is the movement taking place on a scale likely to affect the domestic market or the exchange rate, or both? The

general policy of the central bank will be dependent upon the answers to these questions.

But this policy will be only one factor in bringing about the state of affairs which it is desired to achieve. At all times the central bank must keep itself as well informed as possible in regard to the condition of and the outlook for business in the country's principal markets, so that it may as far as is humanly possible form some idea in regard to prospective developments, favourable or unfavourable.

Having taken all these factors into consideration, the bank decides what the volume of cash should be; that is the size of the combined cash resources of the commercial banks, upon which their credit structure will be based. But the appropriate amount of cash at any given moment cannot be determined without reference to the rate of turnover of the medium of payment, that is the rate of turnover of deposits and money, sometimes called the velocity of circulation. This cannot be known with exactness, but such things as bank deposits and clearings and the course of prices give a good indication. Changes in the national income are more conclusive evidence, but may be available too late to be of use.

There have been many examples of the policy of a central bank being determined by the real or supposed short term needs of its government. Sometimes, as in the case of a war, these needs are so pressing that they get the right of way, even if the actions taken are not in the long term interest of the country as a whole. But it is obvious that in the ordinary course of events such considerations should be definitely subordinated to the long term requirements of the economy as a whole.

Let me emphasize again that I do not want to convey the idea that a central bank by studying all these factors can arrive at conclusions which can be stated in precise mathematical terms. All this information, however, must be the subject of continuous study and continuous intelligent interpretation. It must be mixed with experience, business sense and a sound sense of public psychology.

This discussion of objectives and criteria has been necessarily somewhat abstract. Perhaps I can make it more concrete if I consider one or two suggestions which have been made by some critics who advocate a much more rapid

expansion of currency and credit than has taken place since the Bank of Canada started its operations.

Is Present Volume of Currency And Credit Adequate?

I shall take first of all the suggestion made by the honourable member for Rosthern on February 8th last, and if I criticize one of his suggestions I do not wish him to think that I am one of those to whom he referred as believing "that there can be no improvement in what they had conceived or what had been conceived prior to their day and generation." His contribution to the discussion of this matter was an admirable one, and if I disagree with his concluding suggestion in regard to monetary policy it is not because I question the sincerity of his convictions or depreciate the time and study which he has given to some of the difficult problems which concern us all. My disagreement is based on my own interpretation of current conditions, and the results which I believe would be sure to follow from his suggested program, which results in my opinion would be little short of disastrous to this country. He does, however, provide me with something tangible by way of suggestion of what should be done by this parliament in the realm of monetary policy.

This suggestion is, in brief, that the Bank of Canada should issue, on the basis of the gold which it holds, an additional $560,000,000 of Bank of Canada notes in order to finance the construction of highways, irrigation projects and other public works. He justifies this additional issue on the ground that the bank, holding as it does $179,000,000 of gold, would have, to quote him, "the right to issue on a sound money basis $718,000,000 worth of currency fully secured on a twenty-five per cent. basis."

In the first place the details of my honourable friend's calculations are not correct. Under the law the bank must keep a reserve in gold of twenty-five per cent., not merely of its note liabilities, but of its combined note and deposit liabilities. It must keep twenty-five per cent. not only of the volume of its own notes but of the volume also of the deposits made by the chartered banks in the central bank. As the bank had over $209,000,000 of deposit liabilities on January 18, the maximum increase legally possible in its note circulation would be about $351,000,000 instead of $560,000,000 as stated by him.

Furthermore he states: "It is regarded as sound financial practice to have a gold coverage of twenty-five per cent.; that is so regarded, I believe, even by the Bank of England."

What the honourable member is referring to, I believe, is a resolution passed by the world economic and monetary conference, held in London in 1933. However, it must first be noted that the twenty-five per cent. minimum coverage recommended by the London conference was recommended as an absolute minimum legal cover, and not as a desirable working ratio. I am going to read that portion of the resolution of the London conference in order to demonstrate that point. The same resolution goes on to say that such legal provision ". . . must not be taken as an excuse for unduly building up a larger superstructure of notes and credits; in other words the effect of this resolution should be to increase the free reserve of central banks and thereby to strengthen their position."

In practice the central banks of the world keep a substantially higher percentage reserve in normal times. On January 26, for instance, the reserve of the Bank of England was 32.7 per cent., based on the old valuation of gold. On the basis of the new valuation, of course, the reserve would be very much higher. The effect of this higher percentage in normal times is that when business recovery reaches a more advanced stage or gold outflows occur, the central bank's reserve may be allowed to run down without violating statutory limitations or causing a restrictive policy to be put into effect, with a consequent contradiction in business activity.

In the second place it should be noted that gold reserves have a dual purpose. Not only do they provide a cover for domestic note circulation, but they also constitute reserves with which to meet a deficit in the balance of payments. The latter purpose, particularly in the case of a debtor country like Canada, might well have, at times, a more deciding voice in determining the amount of gold to be held, than the former. Obviously the amount of currency to be issued must be determined by the actual needs of business rather than by an arbitrary ratio to the amount of gold which is accumulated for diverse purposes.

We come back, then, to the question whether the present volume of currency and credit in circulation in Canada

is adequate for the needs of business and whether a further increase would be beneficial. It must first be understood that an increase in Bank of Canada note issue does not mean more notes in the hands or pockets of the public. Whatever medium be used for issuing the new currency or credit, such as the proposed one of financing the construction of public works, the central bank's notes would be immediately deposited with the chartered banks. An increase of, say $350,000,000 in chartered bank holdings of Bank of Canada notes would increase their cash reserves from the present figure of about $250,000,000 to $600,000,000, and their cash ratio from about ten per cent. to roughly twenty-one per cent.

The sponsor of the suggestion contends that no inflation is intended or would result by thus increasing bank cash, so long as the gold cover of the Bank of Canada did not fall below the twenty-five per cent. minimum. This factor, however, is not a test of inflation. If the banks use their increased cash in the normal way, as a basis for the extension of roughly ten times as much in loans to the public, or for the acquisition of ten times as much in investments, bank deposits would expand by approximately an equal amount until the cash ratio was brought down again to approximately ten per cent. This would mean an increase in bank deposits from the present level of about $2,387,000,000 to something like $6,000,000,000, or more than 2.6 times the level of December 31, 1929. Am I merely old fashioned or orthodox when I say that this would mean a colossal measure of inflation?

Effects of Inflation

Perhaps there are some who believe that such inflation would be desirable, and on the effects of inflation, therefore, I shall be compelled to say just a word or two. Inflation does not increase material wealth but, by increasing the volume and decreasing the value of money, it redistributes wealth. Everyone who by custom or by contract receives income by way of fixed or nearly fixed payments loses by inflation, and everyone who owns real property or an equity in real property gains, at least relatively. In Canadian society this means that the wage earning and salaried classes, the people on relief, the bank depositors, insurance policy holders, rent recipients and bondholders will lose.

To give some idea of the order of magnitude of the classes involved, 2,600,000 Canadians are wage and salary earners, as against approximately 400,000 employers and 600,000 who work on their own account. There are approximately, I think, 900,000 persons on relief. There are 4,084,752 bank savings deposit accounts and roughly 6,500,000 life insurance policies in effect in Canada.

The generally deep-seated illusion that inflation will hit the wealthy classes has been exposed many times by experience. The wealthy classes have generally a much smaller proportion of their wealth in the form of bank deposits, bonds, life insurance policies, annuities and other contractually fixed values than the middle and lower classes, and a much smaller proportion of their total incomes in the form of contractually or traditionally fixed payments such as salaries, wages, interest, rents, pensions and relief payments than either the middle or the lower classes. The wealthy classes do not, of course, all benefit in like proportion, because property values are not all affected in the same manner, but the large owner of equities and the skilful speculator in equities have all the odds in their favour.

No more deliberate method, in my judgment, can be conceived of taking from those who have not and giving to those who have. The pitiful state of the great bulk of the population during the various inflation periods in European countries, and the long, painful struggle before the middle and lower classes ever recovered what had been lost in one stroke, are scarcely arguments for deliberately introducing a policy in Canada to benefit the lucky or astute gambler. No wonder the people of continental Europe, who have passed through a great world war and a great inflation during the last quarter century, are as much concerned today with the possibility of the recurrence of cumulative inflation as they are with the possibility of another great war.

Inflation may look like a scheme by which governments can get something out of nothing. It is not so. The mind of man has not yet solved that particular problem, and never will. Governments have only one source for the funds which they use, and that is the pockets of their people. No tax system may be wholly scientific or wholly equitable. Inflation, however, in my opinion is the most unjust and unwise system of taxation that has ever been devised.

Sound Economic Objects Preferable

The honourable member for Rosthern has referred to the building of roads, and the construction of public buildings, land reclamation projects and armaments in Germany. If that country, "hemmed in by the problems which face her," can find the means for such a comprehensive program, he wonders why we in Canada cannot handle our small unemployment problem. Did it not impress the honourable member that Germany in carrying out her program has made the most strenuous efforts to avoid inflation and has not resorted to the direct currency increases, which he proposes for us, to finance her program? She is too close to the results of her experience in 1923 to try again to accomplish easy results by inflationary methods. Let me say here that in a material way she has great achievements to her credit, and I have every admiration for the financial wizardry shown by Doctor Schacht and his staff. But does my honourable friend really believe that Germany has gone further than we have in solving her problems or that her present economic structure rests on a sound foundation? Does he look forward with confidence to the solution of her economic problems in the next two or three years? Does he realize what has been happening to the standard of living of the German people and the sacrifices which they have had to bear in quantity and quality of food, clothing and other consumers' goods? Does he realize that the tax revenues raised by the state have increased from about 6.6 billions of reichsmarks in 1931-32 to 14.2 billions in 1937-38, and to an estimated 18 billions in 1938-39? Furthermore, does he think that the Canadian public would be willing to accept the methods which have been followed in Germany? I dare say that if we as a people were willing to accept a dictatorship in economics as in other matters; if we were willing to allow a dictator to force us to forego certain things and accept cheap substitutes for others; if we were ready to sacrifice food and clothing and motor cars to good military roads and to rearmament, we could show results somewhat comparable with those which have been obtained in Germany in these respects. But if I understand the Canadian public correctly, I think they prefer freedom to regimentation, more consumers' goods to better military roads, more butter and better bread and better clothing and shoes to more cannon and more bombers.

Velocity of Circulation

I have spoken of only one aspect of the results of excessive expansion of currency and credit which we call inflation. I should say a word about another aspect of even a milder degree of inflation. I refer particularly to the maladjustments in the economy that invariably occur during a period of rapid expansion. As expansion proceeds, prices rise and this process tends to become cumulative, as the turnover of deposits becomes more and more rapid. In this connection, I wish to stress the importance of this turnover factor. The amount of money work performed or, to put it another way, the volume of business transactions effected in money terms, depends not only on the total volume of currency and credit but also on the velocity of circulation of notes and deposits—the number of times the dollar turns over in the course of a year. Too little stress is placed on this velocity factor in most monetary discussions.

Perhaps I can best illustrate its importance by referring to estimates recently published by the Dominion bureau of statistics. According to these estimates, the velocity of circulation of money, (coins, bank notes and dominion or Bank of Canada notes), declined from 26.85 in 1929 (this means that the Canadian dollar in the form of notes or coins turned over on the average 26.85 times during the year) to 17.42 in 1932 and then rose to 21.27 in 1936. Bank deposits, on the other hand, turned over 23.04 times in 1929 and only 14.95 times in 1932, but by 1936 the rate of turnover had increased to 18.26 times. It will be seen immediately how much more important this decline in velocity was in the deflation period, 1929-32, than was the decline in the volume of credit itself. I have already said that bank deposits fell off during this period by about fourteen per cent., but the figures just given show a decline in velocity of over thirty-five per cent. We need not be surprised, therefore, when we learn that the total volume of business transactions effected in Canada declined from an estimated total of over 52½ billion dollars in 1929 to slightly over 29 billions in 1932. I recommend a study of this velocity factor to all inflationists; it seems to be conspicuously absent in their thinking.

Psychological Factors

As I stated a moment ago, the velocity of circulation of both money and credit tends to rise very rapidly as confidence returns and business activity increases. If the public believes that inflation is under way and that the government or the central bank is going to continue to inject new currency or credit into the monetary system, as would necessarily be the case if the program suggested by my honourable friend were accepted by the government, then they would begin to lose faith in the integrity of the monetary unit and a race from the dollar would begin. In other words, the velocity of circulation would increase with enormous rapidity and prices would tend to soar with ever-increasing rapidity.

During a period when this process is under way it is perfectly obvious that there is fertile ground for the development of those maladjustments in the economy which I have already mentioned. Prices do not rise at the same rate in all industries. In those industries where prices tend to rise most rapidly, the prospect of increased future profits acts as a magnet to new capital, and business men increase their investment in fixed plant and equipment. Much of the new investment will prove to be unwise. Speculative activity will become excessive and may find an outlet in commodities or in securities or in real estate, producing the whole series of evils with which we are all too familiar.

Furthermore, there will be maladjustments between the various types of prices — retail prices, wholesale prices, security prices, wage rates, prices of raw materials, prices of finished commodities, etc. All these conditions are the familiar product of an inflationary boom which is bound to result in a serious depression. Essentially, a depression is a state of business in which maladjustments between various industries and between costs and prices make it impossible for a system of private enterprise to function normally, and a business recovery is the stage in which normal equilibrium is gradually being restored.

Dangers of Loss of Control

It may be asked why the central bank could not control such an inflationary boom as I have been describing and prevent these excesses from developing. My answer to

that is that the central bank could probably perform that function, in large measure at least, if it began to exert its controls at a sufficiently early stage. But the point is that if there is a too rapid, and a too extensive, expansion of credit with a view to hastening recovery, the central bank's control is bound to be ineffective. Once the situation gets out of hand, the only thing which the central bank and the government can do is to introduce restrictive measures of such a drastic and comprehensive nature as to bring about the very depression which they had been trying to guard against.

The importance of this point will be recognized when it is remembered that the proposal being considered involves an immediate or rapid increase in bank cash of 240 per cent. I am aware, of course, that the honourable member for Rosthern has suggested that if inflation should threaten as a result of his program, the legal reserve requirement of the chartered banks might be raised to prevent any secondary expansion of bank deposits. Let us assume, first, for the sake of argument, that this could be worked out, although I believe my honourable friend would be the first to recognize the difficulties involved in timing and calculating the necessary adjustments in the reserve ratio to avoid inflationary expansion or deflationary restriction, as his construction program would necessarily extend over two or three years at least.

But if we assume it could be done, what would be the effect? I submit that one of the effects would be that we would be paying for the $350,000,000 program by an indirect tax on the shareholders, depositors and borrowing clients of chartered banks. The banks would have additional deposits of $350,000,000, on most of which they would be paying interest, but through the control of the legal reserve an equal amount would have to be carried by them as idle cash reserves bringing no return. The additional interest load would be met either by reducing the interest paid on all savings deposits or by raising the rate of interest on bank loans, or by reducing dividends to shareholders, or by all three methods. Even if we are not concerned with any long run adverse effects upon our banking system, I ask if it is fair that the whole burden of such a program should be thrown on those classes in the community which use our chartered banking system. Alternatively, if this

is the desire, why not impose a tax directly and be done with it, instead of assuming all the risks involved in tinkering with our currency and credit structure?

Apart from the initial effects of such a program, I shall mention only one other difficulty in the proposal to offset increases in bank cash by raising the legal reserve ratio. What is to happen when the $350,000,000 program has been completed? When the funds are all spent and the banks' cash reserve has been raised to twenty-one per cent., what will take the place of the artificial purchasing power injected into our monetary system? The program in itself will likely have done nothing much to restore the normal functioning of the economic system. On the other hand, it may have done much to retard recovery by undermining confidence, by promoting undue expansion in one or more industries, by raising the price of certain commodities, and by creating a more rigid and a more expensive banking system. If private enterprise is not, as is probable, ready to take up the slack, why not another $350,000,000 program of the same type? Moreover, if a $350,000,000 program is good, why not a $500,000,000 program? Why not, indeed, a billion dollar program? This is the inevitable record of such experiments with the currency.

Confidence in Nation's Currency of Fundamental Importance

Returning to the main proposal, I should mention the possibility that the increased bank cash might not immediately result in a tenfold or, indeed, in any expansion of circulating credit in use. If the business and financial world saw that the government and the central bank had committed themselves to a program of progressively expanding the volume of cash on a huge scale, precisely the opposite result might occur, at least for a time. Although ultimately the process of inflation would be almost certain to get under way, the first effects might be a general stagnation of business. Private business would be reluctant to make future commitments. Private individuals would hold a larger proportion of their funds in idle cash. The velocity of circulation of money and credit would decline, and this decline in the rate of turnover would offset or possibly more than offset the increase in the volume of currency and credit. In other words, a contemplated program involving

such vast inflationary possibilities might destroy the confidence of the business world in the soundness of conditions, and of the public generally in the future of their currency. In recent years we have seen more than one instance of such lack of confidence causing an almost insuperable obstacle to business recovery. The government would, of course, be creating purchasing power by its large public works program financed by inflation, but it would probably be found that the retarding of private business enterprise would much more than offset the stimulus which the government was trying to give.

The fact is, Mr. Speaker, that government spending cannot make up for the paralysis of private enterprise and of private spending which is created by fear and uncertainty. Under an absolute dictatorship, with complete regimentation of business and the private citizen conditions might be different; but under an economic political system such as ours it is essential to maintain the confidence of the millions of individuals and organizations that make their own decisions as to whether they will or will not spend or invest.

PROBLEMS OF BRITAIN'S GOLD

By F. Bradshaw Makin, London

ON THE 31st December last further light was thrown on the monetary gold position of Britain by the issue of a statement giving details of the amount of gold held by the Exchange Equalization Account as on the 30th September 1937. The majority of people were conscious of the fact that there had been a steady growth in the gold holding since 1932, but few realized the extent of the increase, hence the feeling of surprise when the true position was appreciated.

The actual stock of monetary gold on the 30th September last was 116,697,000 fine ounces of which 39,854,000 ounces were held by the Exchange Account and 76,843,000 by the Bank of England. The total value of this huge stock at the current market price of approximately thirty-five dollars per fine ounce is the very considerable sum of 4,084 million dollars.

In arriving at the above valuation it must not be overlooked that the whole of the stock has been valued at the

current price, whereas in actual practice the Bank of England still values its own holding at the statutory price of 21.25 dollars per fine ounce. The gold held by the Bank is shown in the weekly bank return as being worth some 1,630 million dollars and not as 2,689 million; hence there is an undervaluation of approximately 1,059 million dollars. This, however, is not a matter of particular importance at present, though when sterling is finally stabilized the revaluation of the Bank's holding may become a question of great moment.

The main point of interest is the fact that Britain's gold stock has increased in the short space of five years from the sum of 670 million dollars (June 1932) to the present figure of 4,084 million, a more than six-fold expansion.

Before dealing with the question of this expansion in the gold stock it is advisable to make a few comments on the causes affecting gold movements when the gold standard is in operation.

It is often stated that the cause of a gold influx is the appreciation of the exchanges beyond the limits of the gold point. Whilst this statement is quite correct it is nevertheless incomplete as no reason is advanced to account for the appreciation in the exchanges. It is fairly obvious that the exchange position is the result of some fundamental cause which is therefore the real cause of the gold influx. In other words the causes which create the appreciation in the exchange are responsible for bringing about the gold imports.

Causes of Gold Influx

The chief causes which, by means of their effect on the rates of exchange, tend to cause a gold influx are as under;—

A surplus in the balance of trade,
A price level lower than the world price level,
International movements of capital, and
Political fears or psychological factors.

There are other causes operating but they are largely subsidiary to those enumerated above.

Balance of Trade—A surplus in the balance of trade or in the balance of indebtedness will in the long run be compensated by an influx of gold. This does not necessarily infer that any seasonal surplus will automatically cause a

seasonal gold influx, as a surplus of this nature is usually offset or counteracted by an exchange movement specially designed for the purpose. Furthermore a relatively long term surplus does not in itself create a gold influx.

Should, however, the trade surplus be such that it causes an increase in the credit balance existing in the balance of indebtedness and so create an appreciation of the exchange, then a gold inflow will tend to develop. Actually the position is that an advantageous change in the balance of indebtedness will, in the absence of overseas lending, tend to bring about exchange appreciation which in turn will cause a gold influx.

Lower Price Level—A fall in the price level in a country *vis-à-vis* the remainder of the gold standard countries will tend, through the effect on the exchanges, to cause gold to flow toward the country with the lower price level.

Prior to the war the general level of prices throughout the gold standard countries was fairly stable and prices were in a state of equilibrium. Any bilateral changes were not very marked and their influence on the exchanges was only of a minor nature, hence the price level theory was not considered to be of much importance. The restoration of the gold standard after the war, when price levels showed marked divergences, led to a more detailed examination of the theory, and it became very evident that the difference between internal and external prices could and did exercise an influence over gold movements.

A striking example of the effect of prices on gold movements is evidenced by the experience of Britain in the years following the restoration of the gold standard in 1925. As the majority of readers are well aware Britain in 1925 stabilized her currency at too high a level, and to bring British prices and wages into equilibrium with world prices a considerable fall in the internal price level was necessary. The high price level acted in the nature of a bounty on imports and a tax on exports. Consequently a harmful effect on the trade balance was created, resulting in a loss of gold and a general weakness in sterling. Under the operation of a complete and unfettered gold standard, the loss of gold by one country and the corresponding gain by other countries would quickly right the price level by causing a fall in the internal prices of the country losing gold and

a rise in the gold gaining countries. Post war monetary technique, however, is such that the discrepancy in price levels could be perpetuated by central bank action. This would take the form of reduced reserve ratios on the one hand and the sterilization of gold imports on the other.

Movements of Capital — The international movement of capital has increased in no small manner since the war, as a result of the marked change in the international distribution of wealth, the growth of international speculation in stock exchange securities, and the existence of a large fund of short term capital of a particularly volatile nature.

Psychological Factors — The effects of the Wall Street boom of 1928-29 are so well known to Canadian readers that any further comment is unnecessary. The existence of the highly volatile short term capital fund brings us to a consideration of the political and psychological factors. Britain had been the repository of a large volume of foreign capital deposited on short terms and, when in 1931 the political situation in Britain was viewed with a lack of confidence, the withdrawal of these balances caused a serious embarrassment culminating in the suspension of the gold standard. Many of the fears leading to the capital withdrawal were undoubtedly more psychological than political, and so long as there exists political uncertainty, the psychological factor will remain as one of the disturbing influences in international finance.

The suspension of the gold standard in 1931 relieved the Bank of England of its statutory obligation to sell gold, and of course left the exchanges free to move according to the daily position.

Forces Responsible for Increase in Stocks of Gold

To deal with the problems arising on the departure from gold a new monetary technique was developed and the Exchange Equalization Account instituted, an explanation of which was given in THE CANADIAN CHARTERED ACCOUNTANT of August last. As previously stated the gold holding of Britain has increased enormously, therefore it is only natural to ask how this great increase has come about.

It is quite obvious that as the exchanges are no longer tied to gold the old gold points are of no consequence, and the usual effects of exchange fluctuations on gold movements do not develop. Gold imports however could result

from an active balance of payments or through the repayment of foreign investments. As neither of these factors has been responsible for the gold acquisitions some further cause must be sought.

An examination of the position leads to the conclusion that the main forces responsible for the increase in Britain's gold stocks are largely political and psychological and consist of the flight of capital to London, the growth of the sterling bloc,* and to a lesser degree the gold scare of the early summer of 1937.

Since 1932 a large volume of foreign capital has been placed on deposit in London. This capital is of a fugitive nature and a large portion of it may be withdrawn at short notice.

During 1936-37 there was a considerable influx of French funds into London, and though some repatriation has taken place there still remains a substantial balance held on deposit. Capital of this nature is not welcomed in Britain, though no active steps have been taken to discourage its deposit. It has been suggested that no interest should be allowed on this type of capital, and a proposal has been made to the effect that a charge should be levied for its safe keeping. The increase in the gold holding of the Exchange Equalization Account is undoubtedly the result of the continued deposit of foreign balances in London.

The development of the sterling bloc has also tended to bring about an increase in the gold stock of Britain through the converging on London of a portion of the monetary gold stocks of the sterling bloc countries. As these countries regard their balances held in the form of sterling assets as part of their central bank reserves, it is apparent that Britain's gold constitutes the reserve not only of Britain herself but also of the whole sterling group.

To some extent the gold scare of 1937 also had the effect of increasing the gold stocks, as the temporary loss of faith in the metal resulted in the sale of gold in exchange for sterling balances.

Briefly, it appears that Britain has been forced by circumstances to act as the custodian of foreign balances

*The sterling bloc countries comprise Britain, Australia, New Zealand, South Africa, India and Scandinavian countries; Canada is not fully a member.

somewhat against her will. The consequent acquisition of gold has not resulted from an active balance of payments, but has been brought about by causes not related to normal trading.

Effects of Gold Influx on Britain's Monetary System

When considering the effects on the British monetary system of a gold influx it must be borne in mined that at the present time a reduction of the credit base results. This can be illustrated by the events of 1936 when a large influx of French funds took place. Part of this influx was left on deposit with the joint stock banks, and part was hoarded in the form of British currency. The main effects of the influx were that the deposits of the joint stock banks increased and their cash decreased, whilst the note circulation of the Bank of England also increased. The result was a fall in the ratio of cash to deposits and also in the reserve of the Bank. On the other hand the Exchange Account had converted part of its sterling assets into francs and reconverted into gold, therefore the gold holding of the Account had been increased. To broaden the credit base by increasing both the cash ratio and the Bank's reserve all that is necessary is that the Bank should purchase gold from the Account. That a purchase of gold took place is evidenced by the increase of some 200 million dollars in the Bank's gold holding during the period of the 1936 influx. The Bank's action therefore had the effect of recreating gold standard conditions in allowing a gold influx to operate in broadening the credit base.

In December of the same year a further purchase of gold was made by the Bank, when the sum of 325 million dollars was bought from the Account. At the same time the fiduciary issue was reduced by 300 million dollars, so that the net expansion of the credit base was 25 million dollars, which incidently was fully absorbed by the Christmas demand for currency. The lowering of the fiduciary issue from the statutory figure of 1,300 million dollars to 1,000 million dollars occasioned some surprise until it was realized that the Bank in conjunction with the Treasury may reduce the issue without obtaining parliamentary sanction. Furthermore, parliamentary sanction is not required for an increase in the fiduciary issue unless the increase be such that the total issue exceeds the statutory figure of 1,300 million dollars.

Fiduciary Issue New Instrument in Monetary Technique

It is quite obvious that a new instrument is to play a part in the monetary technique of Britain, the instrument in question being the fiduciary issue. A further example of the new technique is observed in the alteration of the fiduciary issue in November 1937 when a temporary increase of 100 million dollars was announced. The increase created little surprise as the note circulation of the Bank had been rising, and in view of the further rise to meet the Christmas demand which was impending it was realized that some action had to be taken to prevent a marked fall in the Bank's reserve. The note circulation attained the unusually high figure of 2,545 million dollars, but the return of notes after the holidays quickly brought about a reduction to more normal figures. The temporary increase was cancelled during the week ending 29th January 1938, and the issue is once again fixed at 1,000 million dollars.

Temporary changes in the fiduciary issue avoid the necessity of gold purchases or sales between the Bank and the Account. Bookkeeping difficulties probably arise when gold purchases are made by the Bank, as it must not be overlooked that the Bank values its gold at 21.25 dollars per fine ounce, whereas the Account's figure is approximately 35 dollars per fine ounce. A further point is that numerous transfers to and from the Bank and the Account, may have the effect of creating misunderstanding and misapprehension both at home and abroad.

At present the control of credit and of the monetary machinery is not dependent on gold movements as was the case under the gold standard. New problems call for new methods, and so far the management of the highly complex monetary organization has been carried out with marked success.

HIGH STANDARD IN THE APPEARANCE, CONTENT AND GRAMMATICAL CONSTRUCTION OF ACCOUNTANTS' REPORTS

By Robert D. Gracey, New York City

SOME months ago the following thought-provoking comments appeared in the form of a memorandum addressed to me:

> In view of the fact that in many cases the only contact which the client has with the principals of an accounting firm is through the firm's reports or letters, it follows that these should be of the very highest standard. None of us would enter a client's office with a week's growth of beard and we ought to be equally careful not to allow ourselves to be represented by a carelessly written report or letter.

These remarks, coming from an accountant for whose opinion I have the highest regard, resulted in my undertaking to determine to what extent the reports and letters of certain of the leading firms might be subject to criticism from the standpoint of:

General appearance
Content
Grammatical construction.

For the sake of simplicity I shall deal with each of these points under captions in the foregoing order.

General Appearance

The days have happily passed when a reputable firm of accountants would venture to send out a report or letter containing strike-overs, ugly erasures, or poor alignment in the margin of the text or in columns of figures. For the most part accountants' reports and letters generally, and especially the acccompanying financial statements, have become works of real artistic skill.

To the uninitiated it is often a source of wonder how, in transcribing a report or letter from notes, it is possible for a stenographer to produce a nicely centered piece of typing at the first attempt. Even more to be admired is the skill with which some experienced operators type a twenty or thirty column statement with its group, subgroup and individual columnar captions, its side headings, solid columns of amounts, percentages, and relative descriptions, so that when the subtotals, totals and footnotes have

all been inserted in their proper places, the entire statement is not only typographically accurate but artistically attractive as well. Yet in spite of the remarkable accuracy of well trained typists, too much stress can hardly be laid on the necessity for competent proof reading, rechecking of page numbers, cross references, footings, etc., before a report or letter is finally released.

Granted, especially since the advent of the electric machine, that typing processes themselves have reached practical perfection, something still remains to be accomplished in the matter of ruling. Some accounting firms rule each copy separately with pen and ink (jet black or red); others feel that ruling on the typewriter saves time, reduces likelihood of error and looks as well as pen ruling. My own opinion is that a statement ruled with a fine black ink line is preferable; a subdued ruling more effectively serves the purpose of separating the columns of figures, etc., without unduly calling attention to itself.

Experiments have been made with a view to devising a practical method of multiple pen and ink ruling. For instance, it has been found possible to rule five or six copies of a complicated statement at a time, by means of a glass table illuminated from beneath. Such a method produces ink lines on the ribbon copy and carbon lines on the other copies, which, besides saving time, has the additional advantage of automatically producing fainter lines on the relatively less distinct sheets of text or figures. Perhaps some day soon the production of a new flat-bed typewriter or a practical sprocket device on the regular roller models will ensure perfection in alignment as between the several copies of a single set of sheets, and thus allow of multiple ruling without the risk of finding that the lines in one or more copies have dissected the captions and totals they were intended to underscore.

When more copies of a report are required than can be made at one or two typings, it has become usual to resort to the offset lithographic process. A competent "offset" printer can run off any number of copies at very reasonable cost. This may be done on the accounting firm's usual paper stock, and each duplicate will be identical with the original ribbon copy, red figures, ruling and signature included. An important advantage of the offset process (or

any of the other photographic processes) is the elimination of proof reading, checking additions and calculations, and of ruling and signing each set or copy.

Having prepared a carefully typed report on good quality paper, there is sometimes a tendency to pay insufficient attention to the cover. The cover should be of good, heavy stock, simple and dignified in appearance. Some firms bind their reports with so-called Boston fasteners; others with plain eyelets, while others add a neat lacing of coloured cord or ribbon. Although at times leather covers with gold lettering may be suitable, covers gaudy with elaborate seals or pretentious monograms are sure to make an unfavourable impression. Fewer instances of such tawdriness have been noted in recent years than formerly.

Content

Perhaps the fact that the first impression of our reports and letters is doubtless given by their typographical appearance warrants our having considered that feature first. We turn now to the matter of content. What a report or letter should and should not contain are obviously not questions to be discussed at length in this article. I do wish, however, to emphasize the necessity for keeping up to date with the best methods of presentation by reflecting current trends in accounting and financial practice.

Much more consideration by the investing public has recently been given to accountants' reports; public opinion and the rulings of regulatory bodies have added support and impetus to accountants' efforts towards more adequate disclosure of important financial information. As a result, it should be possible to make our reports and statements more informative through proper emphasis of pertinent facts, while avoiding the multiplicity of schedules, analyses and explanations required in forms prescribed by certain of the regulatory bodies. Our reports may, for example, be improved by the more frequent use of comparative figures. The following excerpt from a fairly recent letter to an eminent accountant from a leading newspaper editor is significant:

> On several occasions I have made the suggestion that all reports to stockholders carry comparisons with the preceding years, or corresponding periods, in both income accounts and balance sheets. I explained that for the stockholders to understand the

progress of the corporation, or lack thereof, such comparisons are necessary as few stockholders retain copies of previous reports.

Newspapers have always recognized this need for comparison and have included it in their reports, but corporate officials and their accountants have, in the main, disregarded this point entirely.

It seems to me that this omission is a relic of the days when the financial statement was meant to reveal as little as possible.

I wonder if you would give me your very valuable views on this subject.

To this the reply was:

I am glad to advise you of my agreement with you as to the usefulness and desirability of comparative forms of statement. I look for steady progress in this direction, and think that you and the other financial writers can very usefully supplement the efforts of the New York Stock Exchange and the American Institute of Accountants to this end.

Of course, no accountant can say that a statement is misleading or inadequate because it does not give comparative figures, and therefore the decision whether they shall be given must always rest with the executives of the corporations. Undoubtedly, also, there are occasions when a comparison is not practicable or might even be misleading, but this is true of only a small minority of cases.

Grammatical Construction

Unfortunately, there is still much room for improvement in the grammatical construction of many reports issued by professional accountants. This may be due to the fact that reports are frequently prepared under great pressure; but we may as well confess that while part of the fault is attributable to lack of proper training, part is due to pure carelessness. Without attempting to be exhaustive, I should like to give some actual examples of several classes of faulty construction.

Ambiguity:

The first example of ambiguity is from a letter written within the past month by an accountant who really did not intend to imply that the client to whom it was addressed might be short of funds:

Since the limited scope of the examination made by us of the company's annual accounts does not assure the ascertainment of irregularities in the accounting for funds of the company, if any existed, it is desirable that the internal control should be adequate and effective and we shall be glad to discuss with you the matters referred to in our memorandum at your convenience, should you desire to do so.

In the following sentence the accountants unintentionally take the position of guaranteeing performance of an agreement:

> Funds to meet the remainder *will be* obtained under an arrangement with four banks whereby they *will loan* $2,500,000 as required, which loan *will be* repaid at stated terms during the period ending May 1, 1945.

Just what the particular firm is trying to say is rather obscure in the next specimen:

> Allen Company, Inc. transferred all of its assets, with the exception of $1,000.00 in cash, to the parent company, Delta Company, as at December 1, 1937 and Delta Company assumed all of the liabilities of Allen Company, Inc. The name of Allen Company, Inc., was changed to Bates Company, Inc. and Delta Company obtained permission to operate in the State of Ohio.

Although we are dealing with reports and letters written by accountants rather than to them, I am tempted to quote from a letter which came into my hands a short time ago from a well meaning gentleman who was seeking a position in the profession on behalf of a friend:

> He cannot afford to gamble with his position, though not exactly a lucrative one, as he has a Wife depending upon him and on account of his age it might be somewhat difficult to obtain another.

Redundancy:

A most common redundancy is "we enclose herewith"; numerous others will readily come to mind upon a little reflection.

Unduly Long Sentences and Paragraphs:

Obviously any sentence is faulty which, because of its great length, needs to be re-read several times in order to be understood. Only an exceptional person could be sure of grasping the writer's meaning after a first reading of this specimen:

> Under Court order dated April 9, 1937, the Hamilton bondholders were allowed a general claim of $13,950.00, subject to the provision that, if all general claims allowed against Hamilton are not paid in full, the dividends on the bondholders' general claims shall not exceed an amount which, together with the proceeds from the sale of the mortgaged assets, will pay to the bondholders the principal amount of the bonds outstanding plus accrued interest thereon to April 30, 1935 and subject to the further provisions that in any event the dividends on the bondholders'

general claim, together with the proceeds from the sale of the mortgaged assets, shall not exceed the principal amount of the bonds outstanding plus accrued interest thereon to date of payment.

An attempt to crowd too many thoughts into the limits of a single sentence produced the following result:

> The coal lands and other real estate, plants, equipment, etc. and investments in The Alpha Company have been adjusted on the books to amounts as appraised by Mr. Samuel Thompson, General Manager, under instructions from the President on account of his knowledge and familiarity with the properties of the company.

This sentence, too, is subject to similar criticism:

> The increase in other income is mainly attributable to discount received on a higher volume of purchases and the decrease in other charges is largely accounted for by the fact that in the preceding period certain organization expenses, $27,892.40, leasehold improvements, $49,300.00, and machinery installation costs, $18,340.22, were included under this classification, whereas, as noted above, expenditures for leasehold improvements and machinery installations during the year under review have been included in manufacturing expense.

A paragraph that fags the mind by its very length obviously requires revision. Hard as it may be to believe, a solid block of forty-one lines recently appeared in an accountant's report.

Brevity:

Brevity, when nothing important is omitted, is worth the effort necessary to achieve it.

As a rule, clearness and brevity go together, indicating that the writer is master of his subject. Most people find it harder to express themselves briefly than at length.

Undue brevity may, on the other hand, appear discourteous. Clients have a right to expect us to be polite and might well be offended by curt communications. However, during the past several years, I have read thousands of letters written by hundreds of accountants; I can therefore say with some confidence that the correspondence of reputable accountants is seldom intentionally impolite.

Errors in Punctuation:

Hard and fast rules for certain kinds of punctuation are neither practicable nor desirable. Where punctuation marks should be placed, and just which marks should be used, are

often purely matters of opinion and taste. Yet even here a suggestion or two may be helpful:

> Occasional use of a semicolon, as an alternative to the conjunction "and," may improve certain sentences from the standpoints of both euphony and clarity.
>
> I think there is much to be said for the practice of putting quotation marks at the beginning of each paragraph which is included in a quotation. Too often, especially within sentences, the closing quotation marks are forgotten. In the case of a series of quoted paragraphs the closing quotation marks are required only at the end of the final paragraph.
>
> When cents have been deliberately omitted, a period should never be placed after dollar amounts, except, of course, at the end of a sentence.
>
> Some accountants leave out punctuation in writing dates. For instance, they write June 30 1937 (within a sentence) without a comma after the "30" or after the "1937." I suggest that consideration be given to the general adoption of this plan.

There is room for standardization in the use of the hyphen. Letters and reports still abound with the following, sometimes hyphenated, sometimes compounded, and sometimes separated:

by-law	interoffice	in so far
safe-keeping	inasmuch	pro rata
trade-mark	goodwill	attorney in fact
out-of-town	letterhead	news stand
	lawsuit	
	footnote	

Hackneyed Phrases, etc.:

Approximately 76% of a large number of reports (selected at random) were found to begin with either "In accordance with your instructions" or "In accordance with instructions received."

Out of one hundred and two letters addressed to the same client over a period of several years, thirty were found to start with "We acknowledge receipt of" or some almost identical phrase. I am not suggesting that such introductory wording is objectionable or that it can always be improved, but I do think it is well that we should realize

to what extent we are in the habit of starting our reports and letters with set phrases.

There is, however, one outworn phrase that I should especially like to see eliminated, that is:

"We *have to* acknowledge"

also its companion:

"We *have to* thank you."

Introductory phrases such as:

"*In this connection* it occurs to us to suggest"

"*We should like to call your attention to* the fact that"

"*Referring to the matter of* internal check reminds us to mention that"

may perhaps be forgiven if used sparingly, but they are, to say the least, hackneyed. Constant use of individual words which are likely to carry over in the reader's memory from one sentence or paragraph to another may also create a poor impression, as, for instance:

nevertheless	unavoidable
moreover	extraordinary
therefore	unfortunate
however	frequently

Poverty in his fund of words may rightly be assumed when an accountant's reports contain such examples of slipshod thinking as:

"These amounts amounted to $9,800.00"

"The balance of the balances were not checked in detail"

"As noted at the foot of the schedules, all the footings were carefully footed"

(For further suggestions regarding business phrases which have become more or less threadbare, the reader is referred to pp. 69, 70 and 93 of the March 1938 issue—Volume 38, No. 3—of the magazine *Correct English*).

Sundry Grammatical Errors and Other Blemishes:

Generally speaking, correspondence and reports bearing the signatures of accounting firms are free from glaring grammatical blunders. One or two firms are, however, more or less frequent offenders. But there are certain types of grammatical errors that now and then escape the scrutiny of even the purists of the profession. Perhaps

the most frequent infractions would include such examples as:

"The examination is to comprise of the following:"

". . . . . the reserve for Federal income taxes was comprised as follows:"

"The capital stock records were examined and the shares held by the Adam Lee estate have been cancelled and new certificates dated May 7, 1935 are now issued as follows:" (Note variety of tenses).

Although defended in certain cases by Fowler's *Modern English Usage*, the use of the word "none" in conjunction with a plural verb is generally considered to be poor form. Sentences such as the following are not unusual in reports, etc.:

> None of the Federal returns for previous years have been examined by the Bureau of Internal Revenue.

I need scarcely point out that the word "none" means "no one."

Frequent repetition of the same word in close sequence may become monotonous. Note, for instance, the undue frequency with which the word "machinery" occurs in these two short paragraphs:

> The old machinery account, having a depreciated balance of $9,894 at June 30, 1937, comprises steam machinery which is idle at the present time. The head office officials state that it has not yet been decided whether or not this machinery will be dismantled and scrapped or a portion thereof retained to be used in case of a breakdown.
>
> With the exception of the new machinery account, depreciation has been provided on depreciated balances at the same rates used in the past, namely, 2% on buildings and 12½% on machinery. Depreciation on new machinery is being provided at the rate of 8% per annum on the cost of the machinery.

Speaking of monotony, the words "the" and "we" are by far the most liable to abuse. The following statistics compiled from four reports written by different accountants give ample proof of this:

	REPORTS				
	No. 1	*No. 2*	*No. 3*	*No. 4*	*Together*
Paragraphs:—					
Total number	34	18	29	29	110
Beginning with "the":					
Number	17	12	17	23	69
Per cent. of total ..	50%	67%	59%	79%	63%

Sentences:—					
Total number	50	28	40	46	164
Beginning with "the":					
Number	25	16	23	33	97
Per cent. of total ...	50%	57%	58%	72%	59%

Particularly in the case of correspondence, the superabundance of "we's" at the beginning of paragraphs and of sentences generally, is, I think, an unfortunate oversight. It is not at all unusual to find a one-paragraph letter consisting of three or four sentences, each of which begins with "we." But a letter of several paragraphs all of which begin with "we" is even more objectionable, as, for instance, in this actual case:

Paragraph 1—We acknowledge receipt of . . . . .
Paragraph 2—We are proceeding . . . . .
Paragraph 3—We have mailed . . . .
Paragraph 4—We are proceeding . . . . .

I heard lately of a man who had such a habit of beginning sentences with "we" that the stenographers of his office nicknamed him "Lindy."

A variety of prepositional phrases in a single sentence is likely to be confusing or at least tiresome. In the following short sentence we have successive phrases introduced with "for," "by," "out of," "to," "by" again, "in" and then "of":

> The test examination for the period covered the expenditures made by the agent out of moneys remitted monthly to him by the home office in the third quarter of 1937.

Many otherwise excellent letters and reports are blemished by careless choice between the use of such ordinary little words as "who" and "whom," "will" and "shall," "should" and "would," "can" and "may," "effect" and "affect," "last" and "latest," "principle" and "principal," "provided" and "providing." Reference to a company as plural in one sentence, and as singular in a later one in the same letter, is likely to give a poor impression to a critical reader; for while either form may be adopted if used consistently, an unnecessary mixture of the two forms is liable to be confusing and may give an impression of carelessness.

No doubt there is something to be said for practical uniformity in the style of our reports to a given client from year to year. Minor changes in choice or merely in arrange-

ment of words without change of meaning may confuse a client by calling unnecessary attention to the structure of our report, and thus detract from its more important contents.

In the introduction to his article on "The Accountant's Report," which appeared in the October 1936 issue of *The Journal of Accountancy,* Mr. D. B. Peter makes the following pertinent remarks:

> Perhaps the best way to drive home the importance of the report—for it is of great importance—is to place yourself in the position of the client who receives it. What does he think of it? Is it written in a manner which will arrest, and hold, his attention, or is it a humdrum affair which he feels compelled to read only from a sense of duty before relegating it to the files? Too many reports are of the latter kind and in this the practising accountant does himself a great injustice, if not actual harm.
>
> When you stop to consider the matter, do you realize that, generally speaking, the only thing which your client receives from you is your report? While preparing your report, do you bear this fact clearly in mind? Do you also bear in mind that your client will be apt to form his opinion of your professional ability solely on the basis of your report? In a great many cases, your report reaches the hands of officers who have not had occasion to watch you at work. They know nothing of the long, hard hours of honest effort you have expended before you are in a position to present your findings. All your work—in fact, all your professional experience—is concentrated in your report, and if your report is poorly presented or awkwardly expressed or loosely constructed or full of grammatical errors, how can the client feel otherwise than that all your work is equally poor or mediocre? The client may easily say to himself while reading your report, "And I pay real money for this stuff." Not only is your prestige damaged by such a thought, but the entire accounting profession is damaged. Professional men are expected to turn out professional work. The word "profession" is defined as "a calling in which one professes to have acquired some special knowledge." Surely the presentation of facts in an understandable manner—and their expression in good English—are expected of the professional accountant.

Mr. Peter's article is well worth consulting for further suggestions with regard to the points which bear constant watching if our reports are to measure up to what is rightly expected of us as professional accountants.

PROVINCIAL TAXING POWERS

At a special session of the Alberta Legislature, held last September, three bills passed by the House were reserved by the Lieutenant Governor for the "Signification of the Governor General's pleasure." In this way, the instructions of the Governor General were sought as to whether assent should be given to the bills in question.

It was finally arranged that for a decision as to the validity of these bills, they should be referred to the Supreme Court. Judgments have recently been handed down with respect to all three, and one of them dealing with the bill containing "An Act Respecting the Taxation of Banks" is of special interest because it discusses the scope of Provincial taxing powers. All three bills were declared to be *ultra vires*, but notice of appeal to the Privy Council has been given so that for a final decision, we will probably have to wait until the Autumn.

The question referred to the Supreme Court of Canada with respect to the Bank taxation bill was, shortly—Is the Bill *intra vires*? The answer given was in the negative. In coming to this conclusion, it was necessary for the court to consider whether the Bill was an enactment in exercise of the provincial power to raise a revenue for provincial purposes by direct taxation, or legislation which, in its true character, related to Incorporation of Banks and Banking, a subject of legislation assigned exclusively to the Dominion Parliament.

The rate of taxation to be imposed upon the banks was an annual rate of one-half of one per cent. on the paid up capital, and one per cent. upon the amount of the reserves and undivided profits. The court tested the effect such legislation would have if adopted by all Provinces, and concluded that such a rate of taxation was prohibitive in fact, and doubtless to the knowledge of the Alberta Legislature.

It was noted that the tax upon banks was of proportions which had no parallel in the Alberta system of taxation and although it was in form legislation relating to taxation, its effect, their Lordships thought, was prohibitive and directed to controlling the banks in the conduct of their business. Such legislation, notwithstanding its form, was not within the powers of the Provinces, because its subject matter was really the Incorporation of Banks and

Banking, one of the enumerated subjects of Dominion jurisdiction. The judgment reads: "Any legislation by a province which . . . . is so directed . . . . as either directly or indirectly to frustrate the intention of the Bank Act by preventing banks carrying on their business or controlling them in the exercise of their powers must be invalid."

On the question of where one should draw the line as to the excessive magnitude of such a tax, their Lordships stated that it would be difficult and inadvisable to attempt it, but in this case they found no necessity. "It is plain," they said, "on the face of the Bill that the purpose of it is not to raise a revenue for provincial purposes, and equally plain that taxation of this character throughout Canada, if operative, would completely frustrate the purposes of the Bank Act."

The following reference was also quoted with approval: "*In Great West Saddlery Co.* v. *The King* (1921) 2 A.C. 91, provincial legislation, which had the effect of precluding Dominion trading companies from carrying on their business in the Province unless they complied with certain special terms, was held *ultra vires,* as calculated to abrogate the capacity or derogate from the status which it was in the power of the Parliament of Canada to bestow; and a general principle was laid down that no provincial Legislature could use its special powers as an indirect means of destroying powers given by the Parliament of Canada."

In conclusion, their Lordships summed up in these words:

"The specific ground on which, in our opinion, this legislation is invalid is: It is not competent to the provinces of Canada, by the exercise of their powers of taxation, to force banks which are carrying on business under the authority of the Bank Act to discontinue business; and taxation by one province on a scale which, in a practical business sense, is manifestly prohibitive is not a valid exercise of provincial legislative authority under section 92. Such legislation, though in the form of a taxing statute, is 'directed to' the frustration of the system of banking established by the Bank Act, and to the controlling of banks in the conduct of their business.

"The answer, therefore, to the question concerning this Bill is that it is *ultra vires.*"

G. R. G. Baker.

DEPRECIATION ALLOWANCE UNDER THE INCOME WAR TAX ACT*

THERE are many definitions of depreciation, but I think I cannot do better than give you that of Dicksee.

"Depreciation is a shrinkage of value which, in the ordinary course of events, may be expected to take place, as being a necessary consequence of the possession and engagement of the asset, and consequently is a charge to Revenue."

You will notice that Dicksee particularly specifies two things—the possession of the asset and the engagement of the asset; so does the Income Tax Division of the Department of National Revenue.

The law does not compel any person or corporation to make provision for the wear and tear of an asset, but if no charge is actually set up in the books and financial statements, then the Division will make no allowance for depreciation in that particular period, provided a profit has been made, and will tax the profit shown in full. If a loss is made, we come to an entirely different situation.

As you are all aware, depreciation which takes care of the wearing out or exhaustion of the assets, does not depend on the result shown by the financial statement at the end of the period, but is occasioned by the use of these assets. Therefore, this Division takes the stand that depreciation cannot be postponed in non-profitable periods and larger amounts than the normal depreciation set up in profitable periods. If a financial statement, showing a loss for a fiscal period, is submitted and no depreciation has been set up, this Division will institute into its records one-half of the normal depreciation for the year and add the same to the accumulated total of past periods.

In all cases, when the accumulated depreciation on such assets which are included under the general caption of Buildings, Plant and Machinery, Furniture and Fixtures, etc., reaches a sum which amounts to 80% of the cost value, then this Division limits the allowance to 10% of the normal depreciation on the balance, i.e., on 20% of the assets, plus

*An address delivered 14th January 1938 before the Montreal Chapter of The Canadian Society of Cost Accountants and Industrial Engineers by Rowland Swift, Special Field Auditor of the Department of National Revenue, Ottawa.

the normal depreciation on the additions from the date the accumulated depreciation reserve equalled 80%.

It is a peculiar fact that up to the present time there have been few cases where depreciation on buildings has reached 80%; the buildings were frame construction, which carry a depreciation rate of 5%.

Effect of Repairs, Renewals and Replacements — The depreciation allowance is intended to cover the estimated reduction of utility value occurring in spite of ordinary current repairs. Incidental repairs which neither materially add to the value of the property nor appreciably prolong its life, but which merely keep it in an ordinarily efficient operating condition, should be deducted as an expense item, and repairs in the nature of replacements which do appreciably prolong the life of the property and arrest deterioration should be classed as capital expenditures or be charged against the depreciation reserve. An item which might be classified as a capital expenditure under certain circumstances may, under different facts and circumstances, be considered an expense item. The particular circumstances in such cases should be taken into consideration in determining into which class the expenditures fall. While property in use, even though kept in good repair, has only a limited expectancy of usefulness, it is nevertheless true that the expectancy of usefulness is largely dependent upon the extent to which repairs are made and the property maintained. Accordingly, in determining the depreciation allowance, due weight must be given to the taxpayer's accounting policy with respect to repairs, maintenance, replacements, and charges to the capital account and to the depreciation reserve.

Salvage Value—Salvage value is the net amount realizable from the sale of an asset, the usefulness of which is in the taxpayer's business exhausted, in excess of the cost of dismantling or removing the asset. It should be taken into consideration when computing depreciation by deducting it from the cost or other allowable basis.

Depreciation may not be allowed on property already depreciated to the point where its present value represents salvage, scrap, or junk value.

Any asset acquired or disposed of during the taxable year for which the depreciation is being computed should

be depreciated only for the actual number of months during which such asset was in use. However, where changes are small in amount and so numerous as to make it impracticable to compute the actual time that each asset was in use, the net amount of the additions for the taxable year may be averaged by dividing the total expenditures during the whole year by two.

Methods of Apportionment

Straight Line, and Other Methods—The capital sum to be replaced by allowances for depreciation over the useful life of the property may either be deducted in equal annual installments, this plan being generally known as the "straight line," or "fixed percentage" method, or in accordance with any other recognized trade practice, such as apportionment to units of production. Whatever plan or method of apportionment is adopted must be reasonable and should be described in the return.

The "straight line" or "fixed percentage" method as applied by the Commissioner assumes the rate of depreciation to be uniform during the useful life of the property. The simplicity of the straight line method of determining depreciation makes it administratively desirable, and generally, it appears that the straight line method approximates the actual depreciation as nearly as any of the other so-called scientific methods. However, in the case of assets used in the extraction of natural resource deposits and in certain other cases, the unit of production method would appear to reflect more accurately the depreciation sustained. The Income Tax Division, however, will neither approve nor disapprove the use of a particular method in advance of the audit of returns, but whatever plan or method is adopted by the taxpayer, if reasonable, will be accepted.

Item and Composite Rates of Depreciation—This Division does not look with favour upon allowances for depreciation computed on a composite rate and, in all cases, this policy has been adhered to, with the exception of public utilities power companies, where the rates of depreciation have been fixed by the Public Utilities Commissioners operating in the provinces under provincial jurisdiction. The allowances for depreciation should be computed and recorded with express reference to specific items, units, or groups of property, each item or unit being considered

separately or included in a group with others to which the same factors apply.

The Income Tax Division considers depreciation by items, or by the groups of items having practically identical physical characteristics and length of life, to be the sound method of accounting.

The Income Tax Division is aware of the fact that, where such rates are attempted to be determined in respect of numerous assets having widely different spans of life, there is no satisfactory method of checking the accuracy of the rate by actual experience. Even with respect to units having estimated lives of similar duration, it is only a matter of chance when a particular unit is discarded or consumed at the exact end of its estimated life. The composite rate presupposes compensating errors wherein depreciation will be allowed over a period longer than the expected span of life on some items and will be allowed over shorter periods in the case of items which are discarded prior to the expiration of their estimated average lives. These compensating errors necessitate the ruling, inherent in composite rate cases, that no loss or deduction with respect to the retirement of specific depreciable assets included within the composite rate will be recognized unless it appears that the cost or other basis of such assets has not been recovered through prior composite depreciation allowances, bearing in mind the relative weight accorded such assets in arriving at the composite rate; provided, that the composite rate is redetermined to give effect, if any, to the resulting increase in the average lives of the depreciable plant assets to which such composite rate has been applied. Where no such loss is claimed on the premature discardation of assets, no redetermination need be made of the composite rate then employed.

The Income Tax Division further recognizes that, except through inspections of the proportionate relation which reserves built up through composite rates bear to the asset accounts, there is little hope of determining when depreciation in excess of 100 per cent. recovery of cost is being allowed. Since, as hereinbefore explained, the function of the depreciation allowance is to return capital over the period of life of the asset and, for that reason, since allowances in excess of 100 per cent. of the cost or other basis are erroneous, composite rates of depreciation applied to mixed aggregates of assets have been rejected by the Income Tax Division.

INCOME WAR TAX ACT DECISIONS

1. The Johnson Matthey Case

In a proceeding in the Exchequer Court of Canada brought by His Majesty the King on the information of the Attorney-General of Canada as plaintiff against Johnson Matthey & Company (Canada) Limited as defendant, Mr. Justice Maclean rendered judgment on 24th March 1938 in favour of the plaintiff. The claim was for an amount alleged to be due and payable by virtue of the provisions of section 9B subsection 2 of the *Income War Tax Act*—the so-called 5% non-resident tax section.

Stock Dividend

The directors of the company in 1933 enacted a by-law, which was duly confirmed by shareholders, empowering the directors to issue shares of the company as fully paid for the amount of any dividend which they might lawfully declare payable in money. In December 1935 a resolution was passed by the directors referring to the by-law and declaring a dividend "on the issued share capital of this Company in the form of an issue of whole shares of this Company's capital stock of such aggregate par value as shall be, as nearly as may be, equal in total amount to the surplus of this Company on 31st December 1935 less the amount of a fair reserve for any taxes, the amount of which may be based upon the operations of this Company up to 31st December 1935, as the same may be determined by this Company's auditors, and that the same are hereby allotted and directed to be delivered on 2nd January 1936 pro rata to the shareholders of this Company of record at the close of business on 31st December 1935 or as they may respectively direct."

The auditors in due course supplied the figure of $49,-571.51 for the purposes of this resolution, and 4,957 shares of the par value of $10.00 each were allotted to the shareholders of record on 31st December 1935. The sum of $49,570 was transferred from "earned surplus" account to the credit of the share capital account. The learned judge stated that the whole of the earned surplus so capitalized was available prior to its capitalization for the payment of cash dividends to the shareholders. Johnson Matthey & Company Limited, an English company and a non-resident of Canada, was entered on the register as the owner of

4,907 of the said 4,957 shares and it received certificates representing them. The defendant did not collect or withhold, or pay the tax in respect of the 4,907 shares so allotted to Johnson Matthey & Company Limited.

Contention of Defendant

The learned judge referred briefly to the submission on behalf of the defendant. It was said that what took place was simply a capitalization of surplus and a distribution of shares and that there was no payment of a dividend because nothing was divided and nothing changed; that no "Canadian debtor," no "payment" and no "currency" were involved in the transactions that took place. The quoted words appear in subsection 2 of section 9B. By subsection 2 the income tax of five per cent. is imposed on all persons who are non-residents of Canada in respect of all dividends received from Canadian debtors irrespective of the currency in which the payment is made. It was argued that the section contemplates only the case where a dividend is being paid in Canadian funds and that therefore a stock dividend is not taxable under that section notwithstanding that section 2(b) of the Act provides that "dividends" include "stock dividends."

Judgment

Mr. Justice Maclean gave judgment in favour of the plaintiff. He pointed out that a statute was being dealt with which plainly declared that "dividends" included "stock dividends." He thought that the words "payment" and "currency" were perhaps not apt words in the case of a "stock dividend" but that they did not obscure what appears to be the intention of the legislature. Given the knowledge that stock dividends are taxable and the whole of the earned surplus being available for the payment of cash dividends there should be no difficulty in providing for withholding and payment of the tax. It might appear at first that the section was not practically operative but as stock dividends are dividends and taxable it was the task of the company declaring it, and under the obligation of withholding the tax, to make some provision for the collection of the tax. His Lordship thought a judgment in 1914 of the Judicial Committee of the Privy Council in an Australian case, *Swan Brewery Company Limited* v. *The King,* was applicable. The taxing Act involved was *The*

Dividend Duties Act, 1902, of Western Australia, which defined dividend to include "every profit, advantage or gain intended to be paid or credited to or distributed among the members of any company." New shares were created and allotted to the then shareholders in proportion to their holdings. The shares so allotted were paid up by the transfer of the required amount from a reserve fund. The Judicial Committee held that these transactions were in effect a declaration of a dividend which was accordingly taxable. In delivering the judgment Lord Sumner dealt at some length with the main argument for the company. This was that there had been no dividend and no distribution because nothing had been divided and nothing changed. Where formerly there had been one share enhanced in value by its right to participate in the reserve fund, if the company, being solvent, should be wound up voluntarily, now there were two, possessed of the same right of participation, but for that very reason worth no more and no less together than the one share was worth before. Their Lordships found the argument unsound. New shares were in fact distributed and they were fully paid. It was not true that there was only one transaction. There were in fact two, the creation and issue of the new shares and on the allottee's part the satisfaction of the liability to pay for them by acquiescing in the transfer from reserve to capital account which put an end to any participation in the sum so transferred in the right of the old shares and created instead a right of general participation in the company's profits and assets in right of the new shares without any further liability to make a cash contribution in respect of them. They agreed with Chief Justice Parker of the Supreme Court of Western Australia who said "Had the Company distributed the £101,450 among the shareholders and had the shareholders repaid such sums to the Company as the price of the 81,160 new shares, the duty on the £101,450 would clearly have been payable. Is not this virtually the effect of what was actually done. I think it is."

2. The Riddell Case

On 26th March 1938 Mr. Justice Angers of the Exchequer Court of Canada delivered judgment allowing the appeal of Mrs. Mary M. Riddell from an income assessment confirmed by the Minister of National Revenue.

Mrs. Riddell is the widow of Alexander F. Riddell, late of Montreal, and a partner of the firm of Riddell, Stead, Graham and Hutchison, chartered accountants. By the will of her husband she was entitled, during her lifetime, to the net income and revenue of his estate after an annuity of $5,000 per annum to the testator's son. In cases of doubt as to whether assets or liabilities were to be credited or charged to the capital or revenue of the estate the testator expressly declared that the decision of his trustee, the Royal Trust Company, should be final and binding upon all parties.

Mr. Riddell died on 24th September 1932. On 11th July 1932 he entered into an agreement with his then partners by which it was declared and agreed that from 1st July 1932 his share and interest in the firm should be that of a special partner with a salary of $15,000 per annum during his lifetime and to continue for six months after his death. As and from the date mentioned he was not to be liable as a partner for any losses of the firm that might thereafter arise.

Alleged Additional Income

On 27th December 1932 the firm of chartered accountants paid the Royal Trust Company, as executor and trustee, under the agreement, the sum of $3,750. In a statement of facts jointly submitted to the Court by the parties to the action it was admitted that the net revenue of the estate apart from the payment of $3,750 was sufficient to pay the proportionate part of the annuity to the son due for the 98 days remaining in the year after Mr. Riddell's death and to leave a surplus. In her personal return of income received in 1932, Mrs. Riddell did not include the $3,750 and she did not in fact receive it nor was it placed to her credit by the trustee. The inspector of income tax at Montreal added $3,750 to her return, alleged in the notice of assessment as being "additional income from estate A. F. Riddell being amount paid to estate A. F. Riddell under agreement with partners of Riddell, Stead, Graham and Hutchison." The inspector levied an additional tax of $301.93.

Contention of Parties

The appellant, Mrs. Riddell, contended that the agreement of 11th July 1932 constituted a sale and that her

husband had thereby sold to the partnership the right to use his name as well as his share and goodwill in the firm. It was admitted in the statement of facts that the Royal Trust Company had treated the sum of $3,750 as an accretion to the capital of the estate. Thus, the widow contended, it had not been paid or credited to her and even if it was not capital but income the Commissioner of Income Tax had assessed the wrong party and should have assessed the Royal Trust Company as trustee.

The Minister contended that the agreement did not constitute a sale and accordingly the annual payments, including the amount payable for the six months after death, were income; that the power in the will to the trustee to determine what was capital and what was income did not bind or affect the Crown; that Mrs. Riddell was entitled to the whole income after the annuity to the son and apart from the $3,750 there was more than enough income to pay the proportionate part of the annuity to the son and that accordingly the $3,750 should have been credited and paid to Mrs. Riddell and was in fact her income.

Judgment

Mr. Justice Angers would not agree that the agreement of 11th July 1932 constituted a sale. In the judgment he quotes extensively from the judgment of Mr. Justice Rowlatt in an English case, *Mackintosh* v. *Commissioners of Inland Revenue* reported in 14 Tax Cases at p. 15. In that case, a partnership agreement provided that in the event of the death of a partner the remaining partners might continue to use the firm's name, marks and goodwill, paying to the estate of the deceased partner the sum of £500 quarterly for five years after which the right of use would continue without further payment. One of the partners died leaving one half of his residuary estate in trust for his widow. She was charged for income tax purposes with one half of the quarterly payments received in 1925-26. Mr. Justice Rowlatt thought the point an extremely narrow one but concluded the quarterly payments were income and not purchase price. The way the partnership agreement was drawn it was not as if the remaining partners had bought the right of use outright paying for it in instalments. They were paying for the right of use as the use took place, the payment being concurrent with the enjoyment of the thing

for which the payment was made, and therefore prolonging the interest of the deceased partner in the income even though only for five years.

Mr. Justice Angers held that the sum of $3,750 paid by Riddell, Stead, Graham and Hutchison was income but, giving effect to the contention of the appellant, he decided that she had been improperly assessed nevertheless. She had not received the sum or any part of it but only income arising therefrom. The Commissioner should have assessed the Royal Trust Company as trustee. He agreed with the Minister, however, that the right conferred by the testator upon his trustee to decide whether assets or liabilities ought to be credited or charged to the capital or revenue of the estate did not affect the rights of the Crown.

(Editor's Note—A copy of the full judgments has been sent to the reference library of each Provincial Institute).

THE DOMINION ASSOCIATION OF CHARTERED ACCOUNTANTS

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GENERAL NOTES

Matters of Interest to Members

Charter of Dominion Association Amended—Members of The Dominion Association of Chartered Accountants will recall that at the 1937 annual meeting held in Vancouver the executive committee was authorized to make the necessary arrangements for amending section five of the Act of Incorporation to provide for an increase in the membership of the council of the Association. Application was accordingly made to the Dominion Parliament, and on 7th April last the Bill to amend the charter of the Association, having been passed by both Houses of Parliament, was given Royal Assent. For the interest and information of members, the amending Act reads as follows:

> WHEREAS The Dominion Association of Chartered Accountants has by its petition prayed that it may be enacted as hereinafter set forth, and it is expedient to grant the prayer of the said petition: Therefore His Majesty, by and with the advice and consent of the Senate and House of Commons of Canada, enacts as follows:—
>
> 1. Section five of chapter fifty-eight of the statutes of 1902 is repealed and the following substituted therefor:—
>
> "5. The affairs and business of the association shall be managed by a council, consisting of not less than six and not more than thirty members, to be constituted in such manner as may be provided by by-law."

Our Contributors This Month

J. P. De Wet of Winnipeg, who writes on mining taxation in Manitoba, is managing secretary of the Manitoba Chamber of Mines.

The Honourable Charles A. Dunning, Minister of Finance, is well known to our readers. We are happy to be able to publish an address on the monetary system of Canada by so competent an authority as he.

Robert D. Gracey has been attached to the New York staff of the firm of Price, Waterhouse & Co. since 1917. He is at present Personnel Manager, and devotes a considerable part of his time to staff training. For the past two years

Mr. Gracey has been lecturer in Public Accounting Practice at the evening classes of Columbia University.

STANLEY B. LAING is a native of Winnipeg and a graduate of the faculty of arts of the University of Manitoba (1926). He served his articles in the firm of Price, Waterhouse & Co., Winnipeg, and became a member of the Institute of Chartered Accountants of Manitoba in 1932. The following year he was appointed senior assessor of company income tax of the Province of Manitoba, which office he held until the transfer last month of the administration to the inspector of income tax of the Dominion Government. Mr. Laing is a member of the Council of the Manitoba Institute and is also president of the Alumni Association of the University of Manitoba.

F. BRADSHAW MAKIN, who is an economist in London, England, has contributed to our pages on a previous occasion. He is a Fellow of the Chartered Institute of Secretaries and a Fellow of the Royal Economic Society.

Immigration to Canada during 1937

The Immigration Branch of the Department of Mines and Resources has issued a statement of immigration to Canada covering the year 1937.

During the year 15,101 immigrants entered Canada compared with 11,643 in 1936, an increase of 29.7 per cent. Of the total entering the Dominion, 2,859 were from the British Isles; 5,555 from the United States; 1,144 from Northern European countries; while other races numbered 5,543. In each classification, increases in the numbers entering Canada, were recorded in comparison with 1936, the largest increase (47.7 per cent.) being under the classification "other races"; 30.1 per cent. increase in the number of persons coming from the British Isles; 13.9 per cent. increase in the number coming from the United States; and a 40.0 per cent. increase in the number coming from Northern European countries.

The destination of the largest number (6,463) of the immigrants to Canada during 1937 was given as Ontario, 2,611 were going to Quebec; 1,649 to British Columbia; 1,430 to Manitoba; 1,175 to Alberta; 775 to Nova Scotia; 616 to Saskatchewan; 305 to New Brunswick; 56 to Prince Edward Island; 18 to the Yukon Territory; and 3 to the Northwest Territories.

Sittings of Exchequer Court in Maritimes

Announcement has been made in *The Canada Gazette* that general sittings of The Exchequer Court of Canada will be held at the following times and places in the Maritime Provines, "provided that any case or matter to be entered for trial or set down for hearing at any of such sittings is so entered or set down at the office of the Registrar of the Court at Ottawa on or before the 25th day of May, A.D. 1938; and if no case or matter is so entered or set down for any of such sittings, then the same shall not be holden."

At the Court House, in the City of Saint John, N.B., commencing on Monday, the 6th day of June, A.D. 1938, at 11 a.m. (city time).

At the Court House, in the City of Halifax, N.S., commencing on Wednesday, the 8th day of June, A.D. 1938, at 11 a.m. (city time).

At the Court House, in the City of Sydney, N.S., commencing on Tuesday, the 14th day of June, A.D. 1938, at 11 a.m. (city time).

At the Court House, in the City of Charlottetown, P.E.I., commencing on Tuesday, the 21st day of June, A.D. 1938, at 11 a.m. (city time).

The American Institute of Accountants

The year 1937 was a memorable one for the American Institute of Accountants because, as previously mentioned in these pages, it marked the fiftieth anniversary of the organization of the profession in the United States. The Institute has kindly sent us a copy of the beautifully bound volume (544 pages) published to commemorate the occasion, and of the 1937 year book (556 pages) which is the first year book published since the American Society of Certified Public Accountants became merged with the Institute towards the close of the year 1936.

The volume contains not only a record of the anniversary meeting, the lists of officers and committees, the representatives of foreign societies, the messages of welcome and responses, and the addresses and roundtable discussions, but also material on the history of the Institute not presented at the meeting but regarded as being necessary

for the unfamiliar reader to understand and appreciate fully the significance of the occasion.

In addition to a complete list of the members, the year book contains the by-laws, financial statements, and reports of the various committees of the Institute. Anybody wishing to purchase a copy of these volumes should communicate with the Secretary of the American Institute of Accountants, 135 Cedar Street, New York City.

The Profession in South Africa

In our issue of March 1937 reference was made to the profession of accountancy in South Africa and to the work of the Commission appointed in 1934 by the Governor General of the Union of South Africa to inquire into the question of the statutory registration of accountants in that Dominion.

As we noted at that time, the Commission recommended legislation to provide for the registration of members of the profession in the Union of South Africa and to prescribe the conditions of entry into the profession for the future.

At the instance of the four South African Societies, a Bill has now been introduced, as a private member's Bill, in the Parliament of the Union. According to present indications, however, consideration of the Bill will have to be postponed until after this year's elections inasmuch as the session is a short one and is being devoted entirely to government business.

Dust In Their Eyes?

We have not taken steps to authenticate the story that comes from Western Pennsylvania, but it seems that a well-known coal operating company there thought it advisable to have an audit made by a firm of accountants. For several days the accountants worked diligently over the coal company's books and records. Finally the audit was completed and the auditors rendered their report, which was supplemented by a recommendation which read as follows:

"A close examination of the company's business has revealed the fact that lump coal, egg coal, nut coal and

mine-run are for the most part sold at prices which yield a profit. However, slack is invariably sold at prices below the cost of production. We, therefore, strongly recommend that the mining of slack be immediately discontinued."

LEGAL DECISIONS

[EDITOR'S NOTE: The following are brief summaries of recent decisions of the Canadian Courts as taken, by the kind permission of the Canada Law Book Company, from the *Dominion Law Reports*. In each case reference is made to the volume of the *Reports* where the full judgment may be found. It should be kept in mind that the decisions given may not in every case be final.]

Companies—Dominion powers to reorganize insolvent companies — Plan of reorganization — Approval by statutory number of bondholders

(Montreal Trust Co. v. *Abitibi Power & Paper Co. et al.)*

Ontario Supreme Court

The power of the Dominion Parliament under s. 91 (21) of the B.N.A. Act to deal with insolvent estates also enables it to enact legislation governing the reorganization of insolvent companies and to provide the necessary procedure incidental thereto, notwithstanding the existence of provincial legislation in the same field. The plan of reorganizing an insolvent Dominion company is governed by the *Companies' Creditors Arrangement Act* of the Statutes of Canada and not by the provisions of the provincial *Judicature Act.*

Where a bondholders' plan for reorganization is approved by a vote of 49% instead of 50% of the bondholders as required by statute, held although the Court has the discretion in certain circumstances to declare such vote sufficient notwithstanding its lacking the required majority, it will not interfere where there is reasonable ground for opposition to the plan.—[1938] 1 D.L.R. 548.

Companies—Forfeiture of charter by non-user—Right to sue

(Dominion Distillery Products Co. v. *The King)*

Exchequer Court of Canada

Non-user of the corporate powers for three consecutive years, after the corporation had sold its assets and ceased

to carry on business, automatically operates as a forfeiture of the charter without any preliminary procedure and prevents it from further exercising its corporate powers or suing for tax refunds due it.—[1938] 1 D.L.R. 597.

(The following are taken from *Canada Law Reports*)

Income tax—Consolidated returns—Crown not bound by estoppel

(Western Vinegars Limited v. *The Minister of National Revenue)*

Exchequer Court of Canada

Appellant company on April 1, 1931, acquired all the issued capital stock of Reynolds, Moore & Company, Limited, a corporation carrying on the same class of business as the appellant, payment being made partly in cash and partly in preferred stock of appellant company. The fiscal year of appellant company terminates on the 30th November, whilst that of Reynolds, Moore & Company, Limited ended on the 31st March. In April, 1932, appellant filed with the Commissioner of Income Tax consolidated returns for the taxing period ending 30th November, 1931, for itself and its subsidiary and forwarded to the commissioner a cheque purporting to be in full payment of the income tax due by appellant for that period. In 1934, the Commissioner of Income Tax made an assessment against appellant for the fiscal year ending 30th November, 1931; this assessment was confirmed by the Minister of National Revenue and from that decision the appellant appealed.

Appellant contended that the respondent was estopped from claiming further income tax from appellant for the taxing period ending 30th November, 1931; that appellant had the right to file for such taxation period a return consolidating its profit and the loss incurred by its subsidiary; that appellant was entitled to deduct from its revenue profits charged on the containers, in which it sold its products, returned by its customers, it being a condition of the sale that the containers could be returned and that in the event of such return the amount charged for them would be credited to the customers; that appellant should not be charged with interest on the difference between the amount of tax paid by appellant and that assessed.

Held: That the doctrine of estoppel does not apply against the Crown, neither can laches be imputed to the Crown.

2. That prior to the enactment of ss. 3 of s. 35 of the *Income War Tax Act* by 23-24 Geo. V, c. 41, s. 13, the Minister had no power to allow the filing of consolidated returns.

3. That the profits on the containers do not constitute a reserve within the meaning of par. (d) of ss. 1 of s. 6 of the *Income War Tax Act*, and that appellant should be allowed a deduction for the containers returned to it.

4. That appellant is liable for interest on the additional tax exigible as provided by sections 48 and 54 of the *Income War Tax Act*.—[1938] Ex. C.R. 39.

[EDITOR'S NOTE: A summary of this judgment was published in the January 1938 issue of THE CANADIAN CHARTERED ACCOUNTANT, and a copy of the full judgment is in the reference library of each Provincial Institute.]

Income tax—Depreciation—Computation of amount deductible for depreciation—Value

(Pioneer Laundry & Dry Cleaners Limited v. *The Minister of National Revenue)*

Exchequer Court of Canada

Appellant by agreement in writing purchased, through an intermediary company, the assets of a company bearing the same name as appellant and referred to as the "old" company. Appellant claimed a deduction in its income for depreciation on the assets purchased from the "old" company. The Minister of National Revenue refused to allow such deduction on the ground that the "old" company had already been allowed full depreciation on such assets and that the appellant company had taken over those assets at an appreciated, rather than true, value. Appellant appealed from the Ministers' decision.

Held: That depreciation as provided for in s. 5, ss. 1(a) of the *Income War Tax Act*, is to be computed on the real value of the articles concerning which depreciation is claimed, and not on the cost of such articles to the taxpayer.—[1938] Ex. C.R. 18.

[EDITOR'S NOTE: A summary of this judgment was published in the January 1938 issue of THE CANADIAN CHARTERED ACCOUNTANT, and a copy of the full judgment is in the reference library of each Provincial Institute. The appellant has appealed also from this judgment to the Supreme Court of Canada.]

OBITUARIES

The Late Alfred James Doggerell

The Institute of Chartered Accountants of Ontario regrets to announce the death of Alfred James Doggerell at London, Ontario, on 28th March 1938, at the age of 76 years.

The late Mr. Doggerell was admitted to membership in the Institute in June 1917 and had carried on practice as a public accountant in London from 1910 until upwards of a year ago when ill-health compelled his retirement.

The Late John Wesley Rosborough

The Institute of Chartered Accountants of Saskatchewan announces with regret the death at Regina on Friday morning, April 1st, of John Wesley Rosborough, a member of the Institute since 1918. Mr. Rosborough was born at Peterborough, Ontario, in 1882 and went to Regina in 1912 where he became connected with the provincial treasury department but later entered the office of W. J. Dawson, chartered accountant, to complete his training for the profession.

Mr. Rosborough was well known throughout the province, having travelled extensively as auditor for many rural municipalities, villages and towns, and in Regina was greatly interested in civic development. He was an active member of the Metropolitan United Church.

To his widow and five children the Institute extends sincere sympathy.

BOOK REVIEWS

A STATEMENT OF ACCOUNTING PRINCIPLES

Prepared by Thomas Henry Sanders, Henry Rand Hatfield and Underhill Moore

(Published by *American Institute of Accountants,* 135 Cedar Street, New York, 1938, paper, 138 pp., seventy-five cents)

With the wider publicity given in recent years to the accounts of public companies there has been a growing demand for greater uniformity in financial statements. Desirable as it may be to establish something in the nature of standards in such matters as accounting classification and terminology, it is of first importance that financial statements should be prepared in accordance with generally accepted principles of accounting. Text books and accounting magazines do, over a long period of years, bring to the accountant an understanding of the accounting principles which have attained wide acceptance. Nevertheless there is a need for a concise summary of present day practices, particularly in these days of rapid change and development in accounting technique. The appearance of "A Statement of Accounting Principles" should therefore be welcome, especially to the accounting profession.

It is perhaps too much to expect that the principles outlined will meet with whole-hearted acceptance and probably the usefulness of the work might be enhanced by further discussion.

The material is arranged in six parts. Part I contains a broad outline of the fundamentals upon which all principles of accounting rest, namely, the distinction between capital and income, conservatism in accounting and finally, form and terminology of financial statements. Parts II and III deal with the income statement and balance sheet. Part IV presents questions peculiar to consolidated statements. Part V introduces the subject of comments and footnotes in financial reports, and in Part VI the statement is brought to a conclusion with a general summing up of the discussion in the body of the report.

In the main the principles stated follow Canadian practices and such differences as do exist are traceable to variations in statutory and other regulatory requirements.

The authors do not approve of the expression "available for dividends" as applied to net income. The words, though not often found in annual accounts, frequently appear in prospectuses. These words, like the words "cash in bank" and "inventories" when used in connection with financial statements, should not and probably are not taken literally. Many expressions, such as those referred to, have by long usage in accounting statements assumed quite definite meanings. The words "available for dividends" when applied to a figure for net income are intended to mean that that amount and no more may be distributed by way of dividends provided the assets represented thereby are in a distributable form.

The discussion in regard to earned surplus and surplus available for dividends should be interesting to Canadians in view of the provisions in the Dominion Companies Act in regard to "earned surplus," "capital surplus" and "distributable surplus."

It is also interesting to note that some of the United States permit the payment of dividends by a parent company out of purchased surpluses of subsidiary companies.

A new principle has been recommended in respect of consolidated

statements. In the past the differences between the cost of the investment in a subsidiary company and the net book value of the underlying assets have usually been classified as "goodwill" or "capital surplus." It is claimed that it is now recognized that the price paid for the shares of a subsidiary company may establish new values (in consolidation) for the tangible assets as well as the intangible assets.

The publication of "A Statement of Accounting Principles" suggests that a review of Canadian accounting practices ought to be made by some organization whose findings would be generally accepted and provision should be made for continuous revision of the review to meet changing conditions.

HAROLD P. HERINGTON.

Toronto, 20th April 1938.

MY MEMORIES

By Thomas Brentnall

(Published by *Robertson & Mullins, Ltd.*, Melbourne, Australia, 1938, cloth, 320 pp. 7s. 6d.)

The interesting part of Thomas Brentnall's book "My Memories" starts in the opening sentences and continues to the end. To those who overlook the book's significance, however, much of it may fail to arouse real interest, but that is the fault neither of the book nor of the author.

The book, written by the ninety year old author who unfolds to his readers an account of his early life in England and Scotland, of his migration to Australia as a young man, and of the unusual fulness of his life, is written in a language easy to read and in a style that tends to sustain interest. The book is well balanced as it deals with the life of a man prominent and active in his profession as a chartered accountant but who, nevertheless, found time to satisfy his passion for music, the stage, travel and a friendly contact with his fellows—men, women and children. He told an articled clerk in his office that he must choose between his proposed profession and music as he could not manage both but Mr. Brentnall, himself, did so and much more in addition. This evidenced his energy and capacity.

Events are not recorded in chronological order. The author's mind was too full for that and much space is devoted to telling of musicians he met and heard, of actors and actresses he knew and whose acts on the stage he viewed—but to one who realizes the motive of the chronicle, these do not become monotonous.

The author does not always stay with his text. His chapter on "The History of Australian Accountancy" without doubt contains the history but also much that does not relate to that history. The chapter on "My Family" is not confined to the family and, aside from his son, does not deal extensively with the family. However, the story is so delightful in portraying the life of the grand old man, the author, that these things do not seem to matter greatly.

In the last paragraph of the book is a beautiful quotation from a recent address given by Canada's own grand old (or young) man that is particularly fitting and leads the reviewer to think of what a book of memories could be written by the speaker, Sir William Mulock, and of what great interest such a book would be to his fellow citizens.

"My Memories" by Thomas Brentnall is an inspiring book and one that may be read with profit.

Toronto,
28th March 1938. W. S. Ferguson, C.A.

STANDARD PROCEDURE IN AUDITING

By W. J. Back

(Issued under the auspices of the Research Committee of the Society of Incorporated Accountants and Auditors of London, England, 1937, cloth, 50 pp.)

This book presents a carefully considered and condensed expression of opinion prepared by Mr. W. J. Back in collaboration with the Research Committee of the Society of Incorporated Accountants and Auditors, concerning the accepted practice of auditing, distinguishing between the requirements by statute and those of direct contract. It recognizes the difficulty of defining what may be regarded as "the exercise of reasonable skill and care" and endeavours to formulate the requirements of standard practice in auditing as recognized by the profession.

The essentials of an audit are briefly and clearly set out in respect to the customary Balance Sheet items encountered in the ordinary course of audit, and also outlines the method of examination which is considered necessary in ascertaining the accuracy of the Profit and Loss section of the accounts. A short appendix to this work deals with the use of machines as aids to modern accountancy.

Vancouver,
March 1938. W. H. Cotter, C.A.

CORRESPONDENCE

One of our members in a Western Province has sent in an inquiry regarding depreciation on the equipment of bottling plants. With the kind assistance of the Canadian Society of Cost Accountants and Industrial Engineers we have been able to supply him with the following answers which may be of interest to other accountants:

Query—

I have given the matter of depreciation with respect to the manufacturing of carbonated and non-carbonated beverages, such as cases, bottles, barrels, kegs and other plant and warehouse equipment, considerable consideration and would be very much interested to know on what basis other manufacturing plants of a similar nature throughout Canada calculate depreciation on the above named equipment.

I have discussed the matter of depreciation with officials of some bottling plants and they all seem to have various opinions with respect to allowance of depreciation. It would seem that from the information I have been able to gather, that there is no definite and uniform system for the allowance of depreciation on bottles and containers.

I would be very pleased if you could forward me statistical data on the above.

Reply No. 1

In the matter of depreciation: On the regular machinery and equipment assets we follow the rates laid down by the Dominion Income Tax Department. The treatment of bottles, cases and other containers depends, first of all, as to whether they are returnable to the manufacturer or not. Secondly, consideration must be given as to whether a deposit was charged, either above or below cost, to ensure their safe return. In one case, the containers in the hands of the trade would represent a liability at less than cost value; in the other case, they would represent a liability at more than cost—each plan calling for a different treatment.

Aside from these considerations, the treatment of the containers becomes an involved matter, as there are many side issues, such as the treatment of or depreciation provision for reconditioning, repair and replacement. In our experience, we have not found any two operations presenting the same set of working circumstances.

Broadly speaking, the answer has to be provided by the method of handling, the conditions of the purchase and the experience resulting from the circulation of the containers of various types. Obviously glass packages would have a much shorter life than barrels or kegs, and the risk in their movement would be very much greater—all of which goes to show that the question cannot be answered in general terms.

Reply No. 2

Bottles and Cases—Cash deposits to insure return are collected on bottles and cases, and the funds received are credited to a

Container Deposit account, which provides a reserve to cover our liability to customers for deposits. Containers are charged to the various capital asset accounts when purchased. No entries are made in these property accounts for containers put out in the trade on deposit, so that the property account reflects values applicable to containers both in plants and in the trade. At each year end, containers in plants and in the trade are valued at deposit prices, and the property accounts are written down to those values. After the first year this procedure was inaugurated, it has meant that the write-down from cost to deposit prices is necessary only on containers purchased during the year since the inventory in plants and containers in the trade have already been written down as of the end of the previous year. An estimate is made at the first of the year in order to provide a reserve monthly to take care of the year end adjustment. Purchases are estimated for the year ahead, and the difference between estimated cost and the deposit value of the containers is determined. A further estimate is made of the quantity of containers which will be disposed of, such as bottle breakage, cases to be destroyed, and inventory shortages. These quantities are priced out at deposit values. The total of these two estimations is spread over the 12 months of the coming year, and in each month a proportion is set up as a reserve. At the year end the actual figures are computed and the inventories are valued as outlined above, with the reserve thus created, being wiped out.

Barrels, Kegs, etc.—Barrels and kegs are not treated in the same manner as bottles and cases, since they depreciate through use to a point where we find it advisable to dispose of them by sale. The prices at which these containers are usually salable, on the average, are known, and we set a residual value on each type of container, based on the usual sale price.

Deposits are collected on these containers, and the purchase price is debited to capital asset account at the time of acquisition. However, instead of writing these containers down to deposit price at the year end, we write them down to the residual value, but spread this right down over a period of three years. This makes it necessary to "age" the accounts. The number of each type of container in the trade is determined by dividing the deposit liability for each type of container, by the price of deposit per container. Then the number of containers in the trade, thus determined, is added to inventories in plants, after which it is a matter of "aging" the accounts by seeing the number of years' purchases represented by the quantity on inventory and in the trade. In this way, at the end of three years, containers are depreciated down to the residual value and they are not depreciated beyond that point.

TERMINOLOGY DEPARTMENT

The articles in this Department, unless otherwise stated, are originally written by the Chairman of the Terminology Committee and submitted to the members thereof; they are afterwards revised by him after consideration of suggestions made by the members.

If it should be thought that any articles include too much primary or elementary matter, readers are asked to realize that the Committee hopes these articles will be of especial value to Students-in-Accounts; and it is believed that, to impart a thorough understanding, too much emphasis cannot be placed on the fundamental principles on which the ideas connoted in the term defined are based.

(Continued from April issue)

Day Book: In Great Britain this term is mainly used for the record of invoices outward. Here it means a memorandum book or blotter used to record business transactions in their order, these records being afterwards translated into accounting terms through the journal itself or one of its subsidiaries. Both the process and the term are falling into disuse, and the journal itself is becoming the book of first entry.

Debenture: In Canada the terms "bond" and "debenture" are often used interchangeably. What in England would be denominated a debenture is in this country often called a bond when it is under seal. (Mitchell: "Canadian Commercial Corporations.")

In *Levy* v. *Abercorris State Co.* (1888), 37 Ch. D. 260, Chitty, J., defined a debenture as "a document which either creates a debt or acknowledges it, and any document which involves either of these conditions is a debenture. I cannot find any precise legal definition of the term. It is not either in law or commerce a strictly technical term, or what is called a term of art."

The Concise Oxford Dictionary gives: "Sealed bond of corporation or company acknowledging sum on which interest is due till principal is repaid, especially fixed interest constituting prior charge on assets."

Debit: To charge: a bookkeeping entry made on the lefthand side of a ledger account to record that cash, merchandise or services have been supplied to or on behalf of the person, activity or property named in its heading, or an expenditure made on a nominal account. When the total debits exceed the total credits the account is said to be "in debit" or a "debit balance."

Debt: Anything owing by one person to another.

Deferred Charges: Expenditures made by a company or

corporation which result (usually) in intangible benefits, these being either continuous or of indefinite duration, e.g., preliminary expenses on incorporation, moving expenses, etc. Such and similar expenses are usually extinguished by appropriations as profits afford.

The term should not be used for expenditures which have a definite value realizable in future periods, such as insurance premiums prepaid, rent paid in advance, etc.; these finally become charges to Profit and Loss in the period which they cover, and should be called "Prepaid Expenses."

Deferred Credits: Income actually received or otherwise set up for which services are yet to be rendered or time yet to run; e.g., interest received in advance; in insurance companies, unexpired portion of premiums; rents received in advance, etc.

Deferred Income: Deferred Credits.

Deferred Liability: One which by the terms of the contract need not be met until some distant future date, usually not less than one year; e.g., mortgages, bonds, agreements to purchase lands, etc.

Deficiency: The amount by which the liabilities of a concern exceed the realizable value of its assets.

Deficiency Account: An account accompanying the Statement of Affairs of a bankrupt, showing in detail the causes of the bankruptcy. It should commence with the capital and surplus at the last ascertainable date of solvency, to which are added capital subsequently provided and any profits made; these to be offset with trading losses and drawings, any shrinkage in asset values, and any extraordinary losses. It should balance exactly with the amount of the deficiency as shown by the Statement of Affairs.

Deficit: (a) A distinction is drawn between this term and "deficiency" (q.v.). A deficit represents an impairment of shareholders' capital, and the term is used to describe a debit balance on Earned Surplus Account.

(b) In a non-profit making institution, any shortage of revenues as compared with expenditures.

Del Credere Agent: A consignee who, in consideration for an extra commission (called a "del credere" commission), undertakes to indemnify the consignor against the risk of bad debts in their mutual transactions. See "Consignment" and "Account Sales."

Depletion: The reducing, emptying, or using up of natural resources such as those of mines, oil wells, forests, etc. It differs from "depreciation" in that depreciation applies to diminution in value caused by use; depletion is a reduction in quantity caused by consumption.

Depreciation: 1. The diminution in service or physical value of an asset caused by wear and tear, wind and weather, age, obsolescence, etc.

2. Shrinkage in conversion value of foreign moneys or securities arising from economic or other causes.

Depreciation Fund: Money and securities set aside for the purpose of replacing capital assets as necessity arises.

Depreciation Methods: There are a number of "methods" of computing the annual provision for depreciation, each of which has its place according to individual circumstances; there are also many schemes which are distinctly immethodical. The principal plans which may be deemed "methods" are as follows:—

Straight Line: A percentage of original cost, based on the estimated life of the asset, taken annually.

Diminishing (or reducing) balance: A method by which a constant percentage is taken and applied as a credit to the balance of the asset account, thus reducing the balance annually.

Sinking Fund: A system based on the presumption that the annual provision for depreciation will be invested, and calculated so that the accumulated provision with the income from its investment will be sufficient to replace the asset at the end of its useful life.

Annuity: The provision of an equal annual charge which not only takes up the cost of the asset during its useful life but allows for interest on the remaining investment.

Production (or working hours): Depreciation provided on the basis of the use of the asset—a fixed rate per hour for machines, per mile for automobiles and trucks, etc.

There are other terms used for methods of providing for depreciation, but they are mainly modifications of the above.

Detailed Audit: See "Audit and Auditing."

Direct Liability: A present and direct liability of a concern, as distinguished from contingent or other liabilities for which some other debtor is primarily liable.

Disbursements: Actual payments in cash or by cheque. Not to be confused with "Expenditures" (q.v.).

STUDENTS' DEPARTMENT

R. G. H. SMAILS, C.A., Editor

NOTES AND COMMENT

In the light of the article by Mr. A. R. Davis, "Inventory Valuation and Business Profits" which was reproduced in the February (last) issue of this magazine the accounts recently published by a large smelting and refining company in the United States are of considerable interest, not only for their qualified use of the so-called basic inventory method but also for the amount of information which they contain in regard to the inventory item.

The balance sheet of this company shows "Metal Stocks —Valued at the lower of cost or market, except that refined metals sold under contracts for delivery after the balance sheet date, are valued at sales contract prices." The report of the Board of Directors to the shareholders complies with the request of the New York Stock Exchange that annual reports should disclose the possible effect on earnings and financial position of commitments for materials contracted for but not received at the close of an accounting period, and also the treatment in accounting statements of inventory losses. Finally there is appended to the balance sheet a nine hundred word explanation of the company's practice with respect to inventory valuation. The following quotations are from this latter statement.

> In determining cost, there was used the basic principle of "last-in first out"—that is, during the year the cost of purchases of each metal was charged against sales of an equivalent quantity of such metal, the excess quantity, if any, of sales over purchases being charged with its pro rata share of the book value of such metal on hand at the first of the year, or the excess quantity, if any, of purchases over sales being added to inventory at cost of such purchases. Thus, cost at December 31, 1937, of each of these metals was either: (a) the book value at which it was carried at the beginning of the year, if all the year's purchases of metal were sold; or (b) the cost of the excess of purchases, if all such metal purchased during the year was not sold, in addition to and calculated separately from the beginning book value as in (a) which remained in the inventory. If either (a), the beginning book value, or (b), the cost of the excess of purchases, was above market at December 31, 1937, it was reduced to market.
>
> There are at all times tied up in the metallurgical system, large quantities of metals, bought and paid for, but not available for sale. Accordingly, certain quantities of major metals and secondary (used) metals, considered so necessarily tied up in the conduct of the business, have been designated "normal stocks," which may be likened to

a reservoir, from which the Company sells at the outlet (finished product) end from day to day so far as possible, the amount of metal bought at the inlet (raw material) end.

Variations in the price of such "normal stocks" are as immaterial from year to year as variations in the price of the land upon which a plant is situated. Therefore, a Metal Stock Reserve has heretofore been created to prevent the trend of the current income from being clouded by ups and downs, from time to time, in market quotations of "normal stocks" . . . These amounts to set up in the Metal Stock Reserve are believed to be sufficient to absorb possible losses with respect to such "normal stocks" of major metals, if the respective market quotations of the respective metals included therein should fall so low as approximately to equal the lowest domestic market quotations thereof at any time during the last twenty-five years . . . At the close of each accounting period "normal stocks" are valued at the lower of cost or market, and the Metal Stock Reserve debited or credited with the difference between the so adjusted inventory valuation and the valuation as per books before adjustment. This debit or credit is not taken into account in calculating earnings currently or for an accounting period.

The reader will notice that in the final result the inventory of this company is valued in a fairly conventional manner but that fluctuations in the value of the "basic" inventory are absorbed in surplus instead of being allowed to cause wide fluctuations in periodic earnings.

* * *

What Is Wrong With This?

Assume that z is the arithmetic mean between two unequal numbers x and y, that is to say, let

$x + y = 2z$

Then $(x + y)(x - y) = 2z(x - y)$

or $x^2 - y^2 = 2xz - 2yz$

Transposing $x^2 - 2xz = y^2 - 2yz$

Adding z^2 to each, $x^2 - 2xz + z^2 = y^2 - 2yz + z^2$

$\therefore x - z = y - z$

and $x = y$

But by the original assumption x and y were *unequal.*

* * *

STUDENTS' ASSOCIATION NOTES

MANITOBA

A review of the history of the Chartered Accountants Students' Society during the past two months brings to mind the very memorable evening of March 4th when the ninth annual supper dance of the Society was held at the Fort Garry Hotel. The increase in attendance over last year

of forty couples is evidence of the growing popularity of this event, and the two hundred and twenty-four happy expressions gave ample testimony to its success. We are encouraged by the large number of Chartered Accountants who are attending these functions and enjoying them.

In the field of sport our entries in the inter-faculty curling league justified our confidence in them by winning twelve out of fifteen games played and finishing up well in the lead. The hockey and basketball teams were not so successful, but next year will tell a different story.

With examinations less than a month away, the activities of the students are confined to those of a non-social and non-sporting nature, but next month ———.

ONTARIO—Hamilton.

On March 29th last Mr. R. F. Bruce Taylor, C.A. delivered a most interesting and instructive lecture on "Stockbrokers' Accounts and Their Audit."

Mr. George F. Plummer, President of the Ontario Students' Association also attended this meeting and spoke briefly on the activities of the Ontario Association and the purposes that might be served by a local branch. Twenty-five members, including a number of local Chartered Accountants, were present.

The officers of the Hamilton branch are as follows: Honorary President, C. S. Scott, F.C.A.; President, John F. Scott; Secretary-Treasurer, George H. Richmond; Executive Committee, D. Bouskill, A. Madgett, and A. D. Thompson.

ONTARIO—Ottawa

The first annual general meeting of the Ottawa branch of the Chartered Accountants Students' Association of Ontario was held in the offices of A. A. Crawley & Co., on March 28, 1938.

After adopting as read the minutes of the inaugural meeting held last October, the members unanimously approved of the appointment of S. E. Bernier, C.A., as auditor. The Secretary-Treasurer's report was thereupon read and duly adopted.

The officers for 1938 are as follows: Honorary Vice-President, Geo. A. Welch, F.C.A.; Past-President, Joseph Harmer, C.A.; President, Frank Orme; Vice-President, James Currier; Secretary-Treasurer, Gordon Tilley; Execu-

tive, Deans Berry, Cliff Bounsall, Ned Brunton, and Maurice Honeywell.

Plans for the 1938 fall lecture meetings were discussed enthusiastically. It was decided that a social function of some description should be held in the near future in order to maintain the members' enthusiasm through the summer months. Upon this note a very successful meeting thereupon adjourned.

PROVINCE OF QUEBEC—Montreal

The monthly meeting of the Chartered Accountants Students' Society of the Province of Quebec was held in the Windsor Hotel, Montreal, and was attended by one hundred student and graduate members. Herbert Gilbert, president, turned the chair over to Bert Bishop, acting chairman of student affairs who introduced the first two speakers of the evening, Messrs. K. W. Dalglish and H. D. Clapperton. These gentlemen chose a novel method of introducing their subject of Cost Accounting, each alternately discussing the principles, objects, necessity for simplicity, methods, etc. D. R. McLagan then dealt with the problems arising from use of various wage systems from a plant efficiency viewpoint. Standard costs as applied to present day industry were outlined by D. R. Patton. The last speaker of the evening, Charlie Knowles, covered the subject of budgets and showed how the cash and revenue budgets could be made to work side by side, giving fuller utility to this method of business forecasting. This plan of discussion was heartily received by the members and should prove a good model to follow in the future.

Our members were the guests of the Canadian Society of Cost Accountants and Industrial Engineers who staged a Mock Parliament having as issue "Bringing down the Budget." Although the scene was the Arts Building at McGill University and not the House of Commons, many of the psuedo-cabinet ministers and the opposition felt quite real as the weighty arguments fell, and many a slam was hurled. The evening was voted a complete success.

The results of the Test Examinations were announced at the meeting held for discussion of the papers. Three prizes were awarded to those having the highest marks, these going to:

A. Gervais for highest aggregate
L. T. Ellyett for highest in accounting
S. Druker for highest in auditing.

We are deeply indebted to the examination board, A. W. Gilmour, E. L. Jowett and P. K. Nutt, for the excellent explanations of the answers to the questions which they gave and for the great pains taken for the benefit of the students.

PROBLEMS AND SOLUTIONS

Solutions presented in this section are prepared by a practising chartered accountant of the Institute from whose examinations the problem is taken and represent his views and opinions. They are designed not as models for submission to the examiner but rather as such discussion and explanation of the problem as will make its study of benefit to the student. Discussion of solutions presented is cordially invited.

PROBLEM I.

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF ONTARIO INTERMEDIATE EXAMINATIONS—DECEMBER, 1937

ACCOUNTING NO. 1. Question 3.

The following is a balance sheet of X Company Limited (a Dominion Company) as at December 31, 1936, as prepared by the company's accountant:

X COMPANY LIMITED

Balance Sheet, December 31, 1936

Accounts receivable—trade	$102,000.00	Accounts payable	$ 75,000.00
Advance to officials	5,000.00	Bank advances	115,000.00
Bonds redeemed and cancelled—at par	50,000.00	Bonds issued — 6% maturing in 1942 at par	155,000.00
Bills receivable—trade	23,000.00	Capital Stock—	
Cash on hand and in bank	10,000.00	7% Cumulative Preferred Stock	
Deficit	108,000.00	Authorized and issued— 3,000 shares of $100.00 each	300,000.00
Fixed assets—		Common Stock—no par value	
Land	10,000.00	Authorized and issued— 50,000 shares	200,000.00
Buildings, plant and equipment	400,000.00	Reserves—	
Inventories of raw materials, supplies, work in process and finished goods—		Bad debts	12,500.00
Raw materials and supplies	75,000.00	Depreciation (1936)	25,000.00
Work in process and finished goods	100,000.00	Income and other taxes payable in Canada	7,500.00
Sinking Fund cash	5,000.00		
Unexpired insurance	2,000.00		
	$890,000.00		$890,000.00

NOTES—

(1) The fixed assets are valued on the basis of appraised sound values as reported on by Y Appraisal Company Limited as at December 31, 1935. The excess of the appraised sound value

over the net book value amounting to $100,000.00 was credited on the books to "Deficit account."

(2) The inventories are valued at approximate cost which is not in excess of market values.

(3) The bank advances are secured under Section 88 of the Bank Act and by an assignment of the accounts receivable.

(4) Dividends on the preferred shares are two years in arrears.

(5) The advances to officials are for travelling expenses in the company's business.

(a) Prepare the balance sheet in what you consider the proper form having in mind that the company was incorporated under The Dominion Companies Act and that the accounts are to be used for credit purposes.

(b) Prepare brief statements arriving at—

(1) The working capital of the company.

(2) The net worth of the company.

(3) The book value of the common stock.

SOLUTION

X COMPANY LIMITED

Balance Sheet December 31, 1936

ASSETS

Current Assets:			
Cash on hand and in bank		$ 10,000	
Trade accounts and bills receivable	$125,000		
Less—Reserve for bad debts	12,500		
		112,500	
Inventory of raw materials and supplies, work in process and finished stocks valued at approximate cost, which is not in excess of market—			
Raw materials and supplies	$ 75,000		
Work in process and finished goods	100,000	175,000	
			$297,500
Sinking Fund Cash			5,000
Fixed Assets:			
Land, buildings, plant and equipment on the basis of appraised sound values as reported on by Y Appraisal Company Limited as at December 31, 1936, plus the cost of subsequent additions:			
Land		$ 10,000	
Buildings, plant and equipment	$400,000		
Less—Reserve for depreciation	25,000	375,000	
			385,000
Deferred Charges:			
Travelling advances to officials of the company		$ 5,000	
Unexpired insurance		2,000	7,000
Total Assets			$694,500
Deficit from operations			208,000
			$902,500

LIABILITIES

Current Liabilities:			
Bank advances (secured)		$115,000	
Accounts payable		75,000	
Reserve for income taxes and other taxes payable in Canada		7,500	
			$197,500
6% Bonds maturing in 1942—			
Issued—		$155,000	
Less—Redeemed and cancelled		50,000	
			105,000
Capital Surplus—Excess of appraised sound value of fixed assets as at December 31, 1935, over net book value thereof as at that date....................			100,000
Capital Stock—			
7% Cumulative Preferred Stock— Authorized and issued—3,000 shares of $100.00 each		$300,000	
Common Stock—no par value Authorized and issued 50,000 shares		200,000	
			500,000
Note:—Dividends on preferred shares have been paid to December 31, 1934			
			$902,500
Working capital—			
Current assets		$297,500	
Current liabilities		197,500	
Working capital			$100,000
Net worth—			
Capital stock — preferred and common		$500,000	
Capital surplus		100,000	
Deficit from operations		*208,000*	
			$392,000
Book value of common stock—			
Issue value thereof		$200,000	
Capital surplus		100,000	
		$300,000	
Less—			
Deficit per books	$208,000		
2 years' dividends on preferred shares unpaid	42,000	250,000	
			$ 50,000
or per share			$ 1.00

NOTES—(not forming part of solution):—

(a) Student may allocate portion of supplies as representing coal, repair, materials, etc. to deferred charges.

(b) Student may assume any or all of travelling advance to officials as having been expended and write that portion off to Profit and Loss.

PROBLEM II.

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF ONTARIO
FINAL EXAMINATIONS—DECEMBER, 1937
BUSINESS INVESTIGATIONS. Question 1.

A Company operating a factory manufacturing Neckwear and Shirts has been offered a contract for the making (only) of 2,000 dozen shirts at a price of $3.75 per dozen. All materials are to be supplied free by the concern offering the contract.

You are informed that this contract could be handled with the present equipment and without any effect on the producing or marketing of their regular lines. You are also informed that the additional expenditures that would be incurred by accepting this contract are estimated as follows:

(a) Piece Work Wages at same average rate as paid in previous year.

(b) An additional cutter would be required for a period of ten weeks at $30.00 per week. Cutters are not on a piece work basis.

(c) Additional Factory Expenses $500.00.

(d) Allowance for contingencies, etc., $500.00.

The following information is obtained from the Company's last annual statement and from other records (the experience of this single year is quite average in relation to earlier periods and to the industry generally):

	Neckwear Department	Shirts Department
Sales	$155,000.00	$270,000.00
Materials Used	$ 94,500.00	$172,500.00
Wages, Piece Work	18,000.00	27,000.00
Wages, Day Work, Productive	5,000.00	10,000.00
Depreciation of Equipment, etc.	750.00	900.00
Total Distributed Expenses	$118,250.00	$210,400.00

Undistributed Expenses,—	
Wages, Unproductive	$10,500.00
Wages, Shipping	1,800.00
Factory Expenses	7,250.00
Factory Stationery	750.00
Advertising	5,750.00
Rent	4,500.00
Interest and Bank Charges	3,250.00
Office Expenses	6,300.00
Office and Management Salaries	15,200.00
Bad Debts	2,500.00
Salesmen's Commissions	17,280.00

Floor-Space—Neckwear Department	2,800	square feet
Floor Space—Shirts Department	5,700	square feet
Floor Space—Office and Shipping Department	500	square feet
	9,000	

Salesmen are paid the same commission per dozen Neckwear or Shirts. It is estimated that the production for the coming year (excluding this proposed contract) will be the same as during the year just ended, i.e., Neckwear 18,000 dozen, Shirts 15,000 dozen.

State whether or not you would recommend accepting this contract, giving reasons and figures.

SOLUTION

Since the proposed contract could be handled with the company's present equipment and without any effect on the producing or marketing of their regular lines, the only factors entering into the determination of the desirability of accepting the contract are the additional expenditures that would be incurred as compared with the gross cash return.

These factors follow:—

Gross Cash Return		$7,500.00
Piece Work Wages — 2000 doz. at $1.80 per doz.	$3,600.00	
Additional Cutter's Wages—10 weeks at $30.00 per week	300.00	
Additional Factory Expenses	500.00	
Allowance for Contingencies	500.00	4,900.00
Net cash benefit		$2,600.

It would seem therefore that the contract should be accepted.